

State of Hawaii
Department of Health

Financial and Compliance Audit
June 30, 2005

State of Hawaii
Department of Health
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PART I

Financial Section

Report of Independent Auditors

The Auditor
State of Hawaii

In our opinion, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (the "Department") which collectively comprise the Department's basic financial statements as listed in the index, present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department at June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1 to the basic financial statements, the basic financial statements of the Department of Health are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2005, and the changes in its financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the basic financial statements, the Department has restated its department-wide net assets and governmental funds fund balances at June 30, 2004 from the amounts previously reported on by other auditors. We have audited the adjustments described in Note 2 that were applied to restate the June 30, 2004 governmental activities net assets and governmental funds fund balances. In our opinion, such adjustments are appropriate and have been properly applied. As the prior period

financial statements have not been presented herein, the restatement has been effected as an adjustment to the July 1, 2004 department-wide net assets and governmental funds fund balances.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2006 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis and budgetary comparison information on pages 3 through 13 and 36 through 40 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. As described in Note 1 to the Schedule of Expenditures of Federal Awards, the accompanying schedule of expenditures of federal awards was prepared on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, on the basis of accounting described in Note 1, in relation to the basic financial statements taken as a whole.

Prinewaterhousecoopers LLP

Honolulu, Hawaii
June 15, 2006

State of Hawaii
Department of Health
Management's Discussion and Analysis (Unaudited)
June 30, 2005

This section of the State of Hawaii, Department of Health's (the "Department") annual financial report presents management's discussion and analysis of the Department's financial performance during the fiscal year that ended on June 30, 2005. Please read it in conjunction with the Department's financial statements, which follows this section.

Overview of the Financial Statements

This financial report consists of four (4) parts: this management's discussion and analysis, the basic financial statements including the related notes to the financial statements, other required supplementary information, and other information. These components are described below:

Basic Financial Statements

The basic financial statements include two kinds of statements that present different views of the Department:

- The first two statements are department-wide financial statements that provide information about the Department's overall financial position and results of operations. These statements, which are presented on an accrual basis of accounting, consist of the Statement of Net Assets and the Statement of Activities.
- The remaining statements are fund financial statements of the Department's governmental funds, for which activities are funded primarily from appropriations from the State of Hawaii, by revenues from the tobacco settlement agreement, beverage container deposit program and federal grants; the Department's proprietary funds, which consist of revolving loan funds and operate similar to business activities; and the Department's fiduciary funds. The governmental funds are presented on a modified accrual basis of accounting. The proprietary and the fiduciary funds are presented on an accrual basis of accounting.
- The basic financial statements also include a "Notes to Financial Statement" section that explains some of the information in the Department-Wide and the Fund financial statements and provides more detailed data.
- The "Notes to the Financial Statements" are followed by Budgetary Comparison Schedules for the General Fund, Tobacco Settlement Fund, and Deposit Beverage Container Fund which are supplementary information required by the Governmental Accounting Standards Board.

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Department-Wide Financial Statements

The department-wide statements report information about the Department as a whole using accounting methods similar to those used by private sector companies. The statement of net assets provides both short term and long-term information about the Department's financial position, which assists in assessing the Department's economic conditions at the end of the fiscal year. All of the current year revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid. The department-wide financial statements include two statements:

- The *statement of net assets* presents all of the Department's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases and decreases in the Department's net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.
- The *statement of activities* presents information showing how the Department's net assets changed during the most recent fiscal year.

The department-wide financial statements of the Department are divided into two categories:

- Governmental activities – The activities in this section are primarily supported by State of Hawaii appropriations, funds from the tobacco settlement, beverage container deposit administrative fees, federal grants, and fees.
- Business-type activities – These functions normally are intended to recover all or a significant portion of their costs through user's fees and charges to external users. These activities include the Department's two revolving loan funds.

Fund Financial Statements

The fund financial statements provide more detailed information about the Department's most significant funds and not the Department as a whole. The financial activities of the Department are recorded in individual funds. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Funds are reported as a major fund or a non-major (other) fund. The Governmental Accounting Standards Board ("GASB") issued Statement 34, *Basic Financial Statements – Management's Discussion and Analysis- for State and Local Governments*, which sets forth the minimum criteria for the determination of major funds. The non-major funds are combined in a column in the fund financial statements.

The Department has three types of funds:

- Governmental Funds: Governmental funds are used to account for essentially the same functions reported in the governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, governmental financial statements focus on near-term inflows and outflows of expendable resources as well as on the balances of expendable resources available at the end of the fiscal year.

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Because the focus of governmental funds is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. Both governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate comparison between governmental funds and governmental activities in the department-wide financial statements.

- **Proprietary Funds:** Proprietary funds are used to report activities that operate more like those of commercial enterprises. They are known as enterprise funds because they charge fees for services provided to outsiders. They are used to report the same functions presented as business-type activities in the department-wide financial statements. The Department uses enterprise funds to account for the operations of its two revolving loan funds each of which are considered to be major funds of the Department.
- **Fiduciary Funds:** The fiduciary funds account for net assets held in a trustee or agent capacity for others. These funds are not reflected in the department-wide financial statements since these resources are not available to support the Department's programs.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the department-wide and fund financial statements. The notes to the financial statements follow the basic financial statements.

Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information. This section includes a budgetary comparison schedule, which includes reconciliation for the general fund, tobacco settlement fund, and deposit beverage container fund, comparing the excess of revenues over expenditures presented on a budgetary basis to the excess (deficiency) of revenues over expenditures presented in conformity with GAAP as presented in the governmental fund financial statements. This management's discussion and analysis is also Required Supplementary Information that is required to be presented preceding the financial statements.

Financial Highlights

- The financial information for 2004 has been restated to reflect the reporting of governmental activities liabilities, fringe benefits relating to accrued vacation, salaries and wages, and capital assets, and tobacco settlement receivable accrual as of June 30, 2004. The 2004 amounts in the MD&A are the restated balances (see Note 2).
- The Department's total net assets increased by approximately \$38.8 million from \$434.45 million, as of June 30, 2004 to \$473.25 million as of June 30, 2005. The total increase in net assets was attributed to an increase in the Department's business type activities of \$13.73 million and increase in governmental activities of \$25.07 million during the year.

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- The Department's governmental funds reported an aggregate increase in fund balance of \$31.3 million during the year and totaled \$115.2 million at June 30, 2005.
- The Department's proprietary funds, consisting of two revolving loan funds, reported an increase in net assets of \$13.7 million for 2005. Total net assets were \$304.62 million at June 30, 2005.

Department-Wide Financial Analysis

This section includes condensed Department-wide financial information.

Statement of Net Assets
June 30,
(\$000)

| | Governmental Activities | | Business-Type Activities | | Total | |
|----------------------------------|------------------------------------|----------------------------|-------------------------------------|----------------------------|-------------------|----------------------------|
| | 2005 | 2004 (restated) | 2005 | 2004 (restated) | 2005 | 2004 (restated) |
| Current assets | \$ 195,316 | \$ 141,691 | \$ 156,427 | \$ 133,391 | \$ 351,743 | \$ 275,082 |
| Capital assets | 72,120 | 75,613 | 213 | 268 | 72,333 | 75,881 |
| Loans receivable, noncurrent | - | - | 148,103 | 157,283 | 148,103 | 157,283 |
| Total assets | <u>\$ 267,436</u> | <u>\$ 217,304</u> | <u>\$ 304,743</u> | <u>\$ 290,942</u> | <u>\$ 572,179</u> | <u>508,246</u> |
| Current liabilities | \$ 83,715 | \$ 60,541 | \$ 124 | \$ 54 | \$ 83,839 | \$ 60,595 |
| Long term liabilities | 15,086 | 13,199 | - | - | 15,086 | 13,199 |
| Total liabilities | 98,801 | 73,740 | 124 | 54 | 98,925 | 73,794 |
| Net assets | | | | | | |
| Invested in capital assets | 72,120 | 75,613 | 213 | 268 | 72,333 | 75,881 |
| Restricted | 89,225 | 63,804 | 304,406 | 290,620 | 393,631 | 354,424 |
| Unrestricted | 7,290 | 4,147 | - | - | 7,290 | 4,147 |
| Total net assets | <u>168,635</u> | <u>143,564</u> | <u>304,619</u> | <u>290,888</u> | <u>473,254</u> | <u>434,452</u> |
| Total liabilities and net assets | <u>\$ 267,436</u> | <u>\$ 217,304</u> | <u>\$ 304,743</u> | <u>\$ 290,942</u> | <u>\$ 572,179</u> | <u>\$ 508,246</u> |

As noted earlier, changes in net assets may serve over time as a useful indicator of the Department's financial position. As of June 30, 2005, the Department's total net assets were approximately \$473.25 million.

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At June 30, 2005, in addition to cash in the state treasury approximating \$308.1 million, the Department had total loan receivables from county governments in the amount of \$160.3 million arising from its two revolving loan funds. The Department had total liabilities of \$98.9 million at June 30, 2005 of which \$31.9 million relates to accrued wages and employee benefits payable. Approximately \$43.4 million liabilities relate to vouchers and contracts payables. At June 30, 2005, restricted net assets were \$393.6 million. The restrictions arise from legal and contractual agreements.

Statement of Activities
June 30,
(\$000)

| | Governmental Activities | | Business-Type Activities | | Total | |
|------------------------------------|------------------------------------|----------------------------|-------------------------------------|----------------------------|--------------|----------------------------|
| | 2005 | 2004 (restated) | 2005 | 2004 (restated) | 2005 | 2004 (restated) |
| Revenue | | | | | | |
| Program revenues | | | | | | |
| Charges for services | \$ 30,599 | \$ 9,255 | \$ 5,851 | \$ 6,068 | \$ 36,450 | \$ 15,323 |
| Operating grants and contributions | 112,234 | 99,112 | 6,365 | 5,590 | 118,599 | 104,702 |
| General revenues | | | | | | |
| State appropriated funds | 376,866 | 341,802 | - | - | 376,866 | 341,802 |
| Nonimposed fringe benefits | 35,931 | 31,878 | - | - | 35,931 | 31,878 |
| Tobacco settlement funds | 38,509 | 56,690 | - | - | 38,509 | 56,690 |
| Environmental fees and taxes | 17,472 | 8,714 | - | - | 17,472 | 8,714 |
| Total revenues | 611,611 | 547,451 | 12,216 | 11,658 | 623,827 | 559,109 |
| Expenses | | | | | | |
| General administration | 28,250 | 25,929 | - | - | 28,250 | 25,929 |
| Environmental health | 43,624 | 38,558 | 2,182 | 2,160 | 45,806 | 40,718 |
| Behavior health | 229,218 | 216,896 | - | - | 229,218 | 216,896 |
| Health resources | 259,179 | 242,408 | - | - | 259,179 | 242,408 |
| Total expenses | 560,271 | 523,791 | 2,182 | 2,160 | 562,453 | 525,951 |
| Excess before transfers | 51,340 | 23,660 | 10,034 | 9,498 | 61,374 | 33,158 |
| Transfers | (26,269) | (41,963) | 3,697 | 3,697 | (22,572) | (38,266) |
| Change in net assets | 25,071 | (18,303) | 13,731 | 13,195 | 38,802 | (5,108) |
| Net assets | | | | | | |
| Beginning of year | 143,564 | 161,867 | 290,888 | 277,693 | 434,452 | 439,560 |
| End of year | \$ 168,635 | \$ 143,564 | \$ 304,619 | \$ 290,888 | \$ 473,254 | \$ 434,452 |

Governmental activities increased the Department's net assets by \$25.1 million. The increase was partially due to an increase in charges for services of \$21.3 million. Included in the charges for services was a one-time retro Medicaid reimbursement of approximately \$11.0 million. Another contributing factor was the \$35.1 million increase in State appropriated funds.

Revenues of the Department's business-type activities were primarily from charges for services, program investment income and federal assistance program funds and state matching funds. Charges for services

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consist primarily of administration loan fees and interest income on loans related to the Department's two revolving loan programs. The majority of the program investment income is from income earned from participation in the State Treasury Investment Pool System.

For the fiscal year ending June 30, 2005, business-type activities increased the Department's net assets by \$10.0 million before transfers. Key elements of this increase are as follows:

- The Department earned \$3.9 million and \$1.9 from interest income and loan fees from its outstanding loans, respectively.
- The Department earned \$3.7 million from interest income on investments.

Total Department-wide expenses for 2005 were \$562.5 million of which \$560.3 million was for governmental activities. Overall the Department is organized into four major administrations.

Financially, the largest administration is the Health Resources Administration that expended approximately 46% of all expenses. A major program accounted for in this administration is the Healthy Hawaii Initiative. This program seeks to prevent chronic diseases such as heart disease, cancer and diabetes utilizing tobacco settlement funds for programs that work to decrease tobacco use, improve nutrition and promote physical activities. Other significant programs include the Disease Outbreak Control Division which utilizes state and federal bioterrorism funds for emergency response to disease outbreaks, and the Injury Prevention and Control Program that includes the state's mandated Emergency Medical Services funds. The Family Health Services Division that administers the state's Healthy Start and Early Intervention programs for children and the Community Health Division that provides Public Health Nursing Services are responsive to requirements of the Felix lawsuit. The Developmental Disabilities Division that services the disabled clients in the state is also addressing the conditions of the Makin Settlement. As the DOH is responsibly adhering to the court settlement conditions, these are additional reasons why this administration expends the majority of departmental funds.

The Behavioral Health Services Administration expended a significant 41% of departmental funds. This administration is responsible to provide available and coordinated mental health and substance abuse treatment and prevention programs. Programs within this administration are the Adult Mental Health Division (AMHD) that includes the Hawaii State Hospital and Community Mental Health Plan, the Child and Adolescent Mental Health Division (CAMHD), and Alcohol and Drug Abuse Division (ADAD). All of these programs are critical as they provided priority services: AMHD continues to work on the requirements of the Department of Justice court ordered agreement to improve the Hawaii State Hospital and Community Mental Health Plan, CAMHD responds to the requirements of the Felix case, and ADAD responds to the Administration's Ice (drug) initiative and the additional funding appropriated.

The Environmental Health Administration is responsible for the management of the clean air, clean water, solid and hazardous waste, public sanitation, vector control, and purity of food and drugs. It expends approximately 8% of the departmental funds. The programs are heavily federally funded through the Environmental Protection Agency. This administration also manages the Water Pollution Control Revolving Fund and the Drinking Water Treatment Revolving Fund.

Finally, the fourth Administration within the Department is the General Administration unit. It provides the overall leadership, administrative support units, and oversight to the three district health offices and to

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the five administratively attached agencies to the DOH. This administration expends approximately 5% of the departmental funds.

The significant changes in our financial statements from 2004 to 2005 are generally attributable to the requirements of the mandated court settlements and other non-discretionary items. Of significance are the additional revenues and expenditures for the Adult Mental Health and Hawaii State Hospital programs, the Developmental Disabilities Division's efforts to meet the requirements of the Makin Settlement to take more clients off the wait lists and into their program, and the Children with Special Health Needs expenditures to address the needs of the Early Intervention Program tied to the Felix Settlement. It is noted that the Child and Adolescents Mental Health Division has stabilized its Felix client counts and reassigned autistic children to the DDD and others to the Department of Education which have resulted in a significant reduction in this program's expenditures. The Felix Settlement ended in May 2005; however the programs continue to provide all required services.

The other significant increases in expenditures are due to the Alcohol and Drug Abuse Program's increased level of activities to implement the Administration's priority Ice (drug) program, and the Epidemiology program's growth due to federal Bioterrorism program funds.

Significant reductions in funding levels are being experienced by the Tobacco Settlement Special Fund due to the reduced revenue being provided, and general funds reduced from the Healthy Start program being converted to Tobacco Settlement funds.

The Deposit beverage container program was fully implemented in January 2005 with the public's redemption of empty containers. It received revenues from container fees of \$13.6 million, \$9.8 million more than in 2004 due to an increase in the container fee of .5 cent (one-half cent) per plastic and aluminum containers in October 1, 2002 to 1 (one cent) cent in October 1, 2004 which also added glass containers.

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The following table presents revenues and expenditures of the governmental funds for 2004 and 2003 (\$000):

| | 2005 | 2004 (restated) |
|--|------------|--------------------|
| Revenues | | |
| State general fund allotments | \$ 376,866 | \$ 341,802 |
| Nonimposed fringe benefits | 35,931 | 31,878 |
| Tobacco settlement funds | 38,009 | 38,490 |
| Deposit beverage container program | 13,556 | 7,086 |
| Intergovernmental funds | 108,620 | 97,044 |
| Taxes, fees, fines and other | 36,120 | 10,977 |
| Investment income | 2,226 | 2,019 |
| Total revenues | 611,328 | 529,296 |
| Expenditures | | |
| General administration | 27,422 | 26,116 |
| Environmental health | 41,735 | 36,771 |
| Behavioral health | 226,553 | 216,608 |
| Health resources | 258,420 | 228,298 |
| Total expenditures | 554,130 | 507,793 |
| Excess revenues over expenditures before transfers | \$ 57,198 | \$ 21,503 |

The governmental funds consist of the department's general fund, tobacco settlement funds, deposit beverage container funds, intergovernmental (federal) funds, and other sources of funds.

During the fiscal year ended June 30, 2005 general fund revenues were \$409.1 million, including \$35.9 million for fringe benefits paid directly from the State General Fund. General fund expenditures were \$406.5 million, including the \$35.9 million discussed above.

For 2005, the tobacco settlement fund received revenues of \$38.6 million, including investment income of \$0.6 million. \$28.9 million was transferred to other State departments and agencies of which \$4.6 million was for the Hawaii tobacco prevention and control trust fund, and \$9.9 million was for the University of Hawaii to assist in financing the construction of the new medical school facility in Kakaako.

The proprietary funds consist of two funds: Water Pollution Control Revolving Fund and Drinking Water Treatment Revolving Loan Fund and are reported in the statement of net assets and statement of activities as business-type activities.

The Water Pollution Revolving Fund accounts for federal and state funds used to provide loans to county governments for the construction of wastewater treatment facilities and the repayment of principal, interest and fees from such loans and investment of such moneys. During 2005, this fund received \$1.2 million and \$2.1 million of federal and state funds, respectively. The fund also disbursed \$2.0 million in loan proceeds and collected repayments of principal of \$11.0 million.

The Drinking Water Treatment Revolving Loan Fund accounts for federal and state funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and

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the repayment of principal interest and fees from such loans and the investment of such moneys. During 2005, this fund received \$1.3 million and \$1.6 million of federal and state funds, respectively.

The Department accounts for funds held as an agent and/or trustee for certain individuals in the fiduciary funds.

Budgetary Analysis

The following budget information relates to the general fund and tobacco settlement fund for 2004.

| | Budgeted Amounts (\$000) | | Actual on a Budgetary Basis (\$000) |
|-------------------------------------|-------------------------------------|--------------|--|
| | Original | Final | |
| General fund expenditure | | | |
| General administration | \$ 16,494 | \$ 16,767 | \$ 16,505 |
| Environmental health | 16,711 | 16,926 | 16,766 |
| Behavioral health | 178,471 | 180,453 | 179,492 |
| Health resources | 165,493 | 168,044 | 167,287 |
| Tobacco settlement fund | | | |
| Revenues | 50,343 | 50,358 | 38,560 |
| Expenditures | 50,343 | 50,358 | 39,492 |
| Deposit beverage container fund | | | |
| Revenues | 22,026 | 22,026 | 29,442 |
| Expenditures | 22,026 | 22,026 | 21,805 |

The differences between the original budget and final expenditures for the general fund were primarily due to the delay in hiring on vacant positions of many programs throughout the department. Other differences occurred due to contracts being delayed, and lower than expected caseloads for services. The actual expenditures of the general fund were \$ 2.1 million less than the budgeted expenditures.

The amount of tobacco settlement funds collected, \$38.6 million, was \$11.8 million less than the final budgeted amount. The shortfall in revenues collected as compared to amounts budgeted is due to the fact that amounts ultimately paid to the state are based on a complex formula of which the primary determinants are not estimable. The amount expended on a budgetary basis, \$39.5 million, was \$10.9 million less than the final budgeted amount. This was primarily due to variances in program capabilities and operating needs.

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Capital Assets

As of June 30, 2005, the Department had invested approximately \$72.2 million (net of accumulated depreciation) in a broad range of capital assets. This amount represents a decrease of about \$3.4 million. The decrease is primarily related to depreciation expense which approximated \$5 million. See Note 5 to the Department's financial statements for a description of capital assets activities for the fiscal year ended June 30, 2005.

| Capital Assets Governmental Activities June 30, (\$000) | | |
|--|------------------|----------------------------------|
| | 2005 | 2004 (restated) |
| Land | \$ 1,018 | \$ 1,018 |
| Land and building improvements | 134,031 | 133,156 |
| Furniture and equipment | 14,631 | 14,115 |
| Total | 149,680 | 148,289 |
| Accumulated depreciation | 77,500 | 72,676 |
| Total capital assets, net | <u>\$ 72,180</u> | <u>\$ 75,613</u> |

Currently Known Facts, Decisions, or Conditions

The Department will continue to place its efforts on the mental health and substance abuse health priorities of the state. The Disease Outbreak and Control Division and the Disaster Planning Staff have led a Department wide effort to prepare for potential disease outbreaks, natural disasters and other public health emergencies. The first draft of the Basic Disaster Plan has already been completed and the Department will continue to work on it throughout the upcoming year.

The Adult Mental Health Division will continue to work diligently to address the requirements of the Community Plan for out-patients to move toward the dismissal of the Department of Justice's continuing oversight of this Plan. With the Special Master, the Evaluation Team and the Special Monitor assisting the Adult Mental Health Division, the Department hopes to bring the State into compliance with the Community Plan by June 30, 2006. In line with maintaining and improving our mental health services are our priority efforts to advance the administration's substance abuse (ice, alcohol, and drug) initiative. Similar high level efforts will continue to address the court mandates of the Makin Settlement requiring services for the developmentally disabled. Ongoing efforts will continue to meet the needs of the now settled Felix Consent Decree for children and youth with special needs. Significant financial resources will continue to be expended in these areas to meet the required objectives.

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The Water Pollution Control Revolving Fund and the Drinking Water Treatment Revolving Loan Fund is expecting to execute a total of seven loan agreements in the amount of \$67.2 million and 11 loan agreements for \$31.4 million respectively during fiscal year 2006.

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Statement of Net Assets
June 30, 2005

| | Governmental Activities | Business-Type Activities | Total |
|--|------------------------------------|-------------------------------------|-----------------------|
| Assets | | | |
| Current assets | | | |
| Equity in cash and cash equivalents in State Treasury | \$ 167,884,929 | \$ 140,245,228 | \$ 308,130,157 |
| Receivables | | | |
| Accrued interest and loan fees | 242,043 | 2,367,286 | 2,609,329 |
| Accounts receivable | 1,672,570 | - | 1,672,570 |
| Due from Federal government | 6,816,702 | 1,358,270 | 8,174,972 |
| Internal balances | - | 275,000 | 275,000 |
| Tobacco settlement receivable | 18,700,000 | - | 18,700,000 |
| Current maturities of loans receivable | - | 12,180,862 | 12,180,862 |
| | <u>27,431,315</u> | <u>16,181,418</u> | <u>43,612,733</u> |
| Total current assets | 195,316,244 | 156,426,646 | 351,742,890 |
| Loans receivable, net of current maturities | - | 148,103,453 | 148,103,453 |
| Capital assets, net of accumulated depreciation | <u>72,120,180</u> | <u>213,255</u> | <u>72,333,435</u> |
| Total assets | <u>\$ 267,436,424</u> | <u>\$ 304,743,354</u> | <u>\$ 572,179,778</u> |
| Liabilities and Net Assets | | | |
| Current liabilities | | | |
| Vouchers and contracts payable | \$ 43,307,221 | \$ 65,845 | \$ 43,373,066 |
| Accrued wages and employee benefits payable | 9,092,100 | 58,590 | 9,150,690 |
| Accrued vacation, current portion | 7,709,625 | - | 7,709,625 |
| Workers' compensation liability | 585,570 | - | 585,570 |
| Deferred income | 299,039 | - | 299,039 |
| Internal balances | 275,000 | - | 275,000 |
| Due to State of Hawaii | 14,062,400 | - | 14,062,400 |
| Beverage container deposits | <u>8,383,568</u> | <u>-</u> | <u>8,383,568</u> |
| Total current liabilities | 83,714,523 | 124,435 | 83,838,958 |
| Accrued vacation, net of current portion | 15,086,429 | - | 15,086,429 |
| Commitments and contingencies | | | |
| Net Assets | | | |
| Investment in capital assets | 72,120,180 | 213,255 | 72,333,435 |
| Restricted for | | | |
| Loans | - | 304,405,664 | 304,405,664 |
| Tobacco prevention and control | 27,471,061 | - | 27,471,061 |
| Capital projects | 1,151,065 | - | 1,151,065 |
| Other purposes | 60,602,954 | - | 60,602,954 |
| Unrestricted | <u>7,290,212</u> | <u>-</u> | <u>7,290,212</u> |
| | <u>168,635,472</u> | <u>304,618,919</u> | <u>473,254,391</u> |
| Total liabilities and net assets | <u>\$ 267,436,424</u> | <u>\$ 304,743,354</u> | <u>\$ 572,179,778</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Statement of Activities
Year Ended June 30, 2005

| Functions/Programs | Expenses | Program Revenues | | Net (Expense) Revenue and Changes in Net Assets | | |
|--|----------------|----------------------|------------------------------------|---|--------------------------|-----------------|
| | | Charges for Services | Operating Grants and Contributions | Primary Government | | |
| | | | | Governmental Activities | Business-Type Activities | Total |
| Primary government | | | | | | |
| Governmental activities | | | | | | |
| General administration | \$ 28,249,799 | \$ 279,951 | \$ 8,248,360 | \$ (19,721,488) | \$ - | \$ (19,721,488) |
| Environmental health administration | 43,623,745 | 5,545,632 | 9,187,146 | (28,890,967) | - | (28,890,967) |
| Behavioral health services administration | 229,218,375 | 18,902,456 | 16,563,097 | (193,752,822) | - | (193,752,822) |
| Health resources administration | 259,179,275 | 5,870,583 | 78,235,566 | (175,073,126) | - | (175,073,126) |
| Total governmental activities | 560,271,194 | 30,598,622 | 112,234,169 | (417,438,403) | - | (417,438,403) |
| Business-type activities | | | | | | |
| Environment health loan programs | 2,181,760 | 5,850,704 | 6,365,398 | - | 10,034,342 | 10,034,342 |
| Total business-type activities | 2,181,760 | 5,850,704 | 6,365,398 | - | 10,034,342 | 10,034,342 |
| Total primary government | \$ 562,452,954 | \$ 36,449,326 | \$ 118,599,567 | (417,438,403) | 10,034,342 | (407,404,061) |
| General revenues | | | | | | |
| State general fund allotments | | | | 376,866,523 | - | 376,866,523 |
| Nonimposed employee fringe benefits | | | | 35,931,154 | - | 35,931,154 |
| Environment response tax | | | | 1,867,117 | - | 1,867,117 |
| Deposit beverage container fee | | | | 13,555,708 | - | 13,555,708 |
| Advance glass disposal fee | | | | 2,049,579 | - | 2,049,579 |
| Tobacco settlement funds | | | | 38,509,029 | - | 38,509,029 |
| Transfers | | | | (26,269,324) | 3,697,000 | (22,572,324) |
| Total general revenues and transfers | | | | 442,509,786 | 3,697,000 | 446,206,786 |
| Change in net assets | | | | 25,071,383 | 13,731,342 | 38,802,725 |
| Net assets at July 1, 2004, as previously reported | | | | 145,391,469 | 290,887,577 | 436,279,046 |
| Prior period adjustments | | | | (1,827,380) | - | (1,827,380) |
| Net assets at July 1, 2004, as restated | | | | 143,564,089 | 290,887,577 | 434,451,666 |
| Net assets at June 30, 2005 | | | | \$ 168,635,472 | \$ 304,618,919 | \$ 473,254,391 |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Governmental Funds
Balance Sheet
June 30, 2005

| | General | Tobacco Settlement | Deposit Beverage Container | Other Funds | Total Governmental |
|--|----------------------|-------------------------------|---|------------------------|-------------------------------|
| Assets | | | | | |
| Equity in cash and cash equivalent in State Treasury | \$ 55,619,988 | \$ 23,338,967 | \$ 23,017,689 | \$ 65,908,285 | \$ 167,884,929 |
| Accrued interest receivable | - | 4,815 | 19,524 | 217,704 | 242,043 |
| Accounts receivable | - | - | 1,781,178 | - | 1,781,178 |
| Due from Federal government | - | - | - | 6,816,702 | 6,816,702 |
| Total assets | <u>\$ 55,619,988</u> | <u>\$ 23,343,782</u> | <u>\$ 24,818,391</u> | <u>\$ 72,942,691</u> | <u>\$ 176,724,852</u> |
| Liabilities and Fund Balances | | | | | |
| Liabilities | | | | | |
| Vouchers and contracts payable | \$ 27,243,588 | \$ 494,701 | \$ 1,095,599 | \$ 14,473,333 | \$ 43,307,221 |
| Accrued wages and employee benefits | 6,949,692 | 53,020 | 43,232 | 2,046,156 | 9,092,100 |
| Deferred income | - | - | 108,608 | 299,039 | 407,647 |
| Due to State of Hawaii | 37,400 | - | - | - | 37,400 |
| Due to other funds | - | - | - | 275,000 | 275,000 |
| Beverage container deposits | - | - | 8,383,568 | - | 8,383,568 |
| Total liabilities | <u>34,230,680</u> | <u>547,721</u> | <u>9,631,007</u> | <u>17,093,528</u> | <u>61,502,936</u> |
| Fund balance | | | | | |
| Reserved for encumbrances | 40,648,343 | 7,032,050 | 10,048,704 | 34,599,018 | 92,328,115 |
| Unreserved, reported in | | | | | |
| General fund | (19,259,035) | - | - | - | (19,259,035) |
| Tobacco settlement fund | - | 15,764,011 | - | - | 15,764,011 |
| Bottle Bill Fund | - | - | 5,138,680 | - | 5,138,680 |
| Special revenue funds | - | - | - | 21,250,145 | 21,250,145 |
| Total fund balance | <u>21,389,308</u> | <u>22,796,061</u> | <u>15,187,384</u> | <u>55,849,163</u> | <u>115,221,916</u> |
| Total liabilities and fund balance | <u>\$ 55,619,988</u> | <u>\$ 23,343,782</u> | <u>\$ 24,818,391</u> | <u>\$ 72,942,691</u> | <u>\$ 176,724,852</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Reconciliation of the Governmental Fund Balance to the
Statement of Net Assets
June 30, 2005

| | |
|---|-----------------------|
| Total fund balance – governmental funds | \$ 115,221,916 |
| Amounts reported for governmental activities in the statement of net assets are different because | |
| Tobacco settlement receivable (net of Due to State of Hawaii amounts) is not available for current financial resources and therefore is not reported as an asset in the governmental funds. | 4,675,000 |
| Capital assets used in governmental activities are not financial resources and therefore not reported in the funds. | 72,120,180 |
| Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds. | (22,796,054) |
| Workers' compensation liability reported in the statement of net assets does not require the use of current financial resources and therefore is not reported as a liability in the governmental funds. | <u>(585,570)</u> |
| Net assets of governmental activities | <u>\$ 168,635,472</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Governmental Funds
Statement of Revenues, Expenditures and Changes in Fund Balance
Year Ended June 30, 2005

| | General | Tobacco Settlement | Deposit Beverage Container | Other Funds | Total |
|---|----------------|-----------------------|----------------------------------|---------------|----------------|
| Revenues | | | | | |
| State allotment, net | \$ 373,181,523 | \$ - | \$ - | \$ 3,685,000 | \$ 376,866,523 |
| Intergovernmental | - | - | - | 108,619,732 | 108,619,732 |
| Tobacco settlement | - | 38,009,029 | - | - | 38,009,029 |
| Deposit beverage container program | - | - | 13,555,707 | - | 13,555,707 |
| Nonimposed employee fringe benefits | 35,931,154 | - | - | - | 35,931,154 |
| Taxes, fees, fines and other | - | - | - | 36,119,818 | 36,119,818 |
| Interest income | - | 600,666 | 313,881 | 1,311,553 | 2,226,100 |
| Total revenues | 409,112,677 | 38,609,695 | 13,869,588 | 149,736,103 | 611,328,063 |
| Expenditures | | | | | |
| General administration | 18,902,729 | - | - | 8,518,963 | 27,421,692 |
| Environmental health | 18,719,039 | - | 4,472,585 | 18,543,283 | 41,734,907 |
| Behavioral health services | 194,882,911 | - | - | 31,670,031 | 226,552,942 |
| Health resources | 173,964,151 | 8,911,097 | - | 75,545,135 | 258,420,383 |
| Total expenditures | 406,468,830 | 8,911,097 | 4,472,585 | 134,277,412 | 554,129,924 |
| Excess of revenues over expenditures | 2,643,847 | 29,698,598 | 9,397,003 | 15,458,691 | 57,198,139 |
| Other financing sources (uses) | | | | | |
| Transfers in | 2,748,495 | - | 251,262 | 8,709,503 | 11,709,260 |
| Transfers out | (2,205,000) | (28,953,088) | - | (6,445,495) | (37,603,583) |
| Total other financing sources (uses) | 543,495 | (28,953,088) | 251,262 | 2,264,008 | (25,894,323) |
| Net change in fund balance | 3,187,342 | 745,510 | 9,648,265 | 17,722,699 | 31,303,816 |
| Fund balance at July 1, 2004, as previously reported | 30,647,008 | 22,706,051 | 4,956,395 | 39,839,773 | 98,149,227 |
| Prior period adjustments | (12,445,042) | (655,500) | 582,724 | (1,713,309) | (14,231,127) |
| Fund balance at July 1, 2004, as restated | 18,201,966 | 22,050,551 | 5,539,119 | 38,126,464 | 83,918,100 |
| Fund balance at June 30, 2005 | \$ 21,389,308 | \$ 22,796,061 | \$ 15,187,384 | \$ 55,849,163 | \$ 115,221,916 |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balance of Governmental Funds to the
Statement of Activities
Year Ended June 30, 2005

| | |
|--|---------------------|
| Net change in fund balance – total governmental funds | \$31,303,816 |
| Amounts reported for governmental activities in the statement of activities are different because | |
| Accrual of tobacco settlement receivable is reported in the statement of activities but not as revenue in the governmental funds as it was not available at June 30, 2005. | 125,000 |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays for the year. | (3,493,116) |
| Compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. | (2,901,364) |
| Decrease in the noncurrent portion of workers' compensation liability reported in the statement of activities do not require the use of current financials resources and therefore is not reported as an expenditure in governmental funds. | 37,047 |
| Change in net assets of governmental activities | <u>\$25,071,383</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Statement of Net Assets — Proprietary Funds
June 30, 2005

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|---|---|---|-----------------------|
| Assets | | | |
| Current assets | | | |
| Equity in cash and cash equivalents in State Treasury | \$ 125,517,806 | \$ 14,727,422 | \$ 140,245,228 |
| Loan fees receivable | 547,790 | 105,776 | 653,566 |
| Accrued interest receivable | 1,290,396 | 40,350 | 1,330,746 |
| Other accrued interest | 349,860 | 33,114 | 382,974 |
| Due from other funds | - | 275,000 | 275,000 |
| Due from federal government | 7,128 | 1,351,142 | 1,358,270 |
| Current portion of loans receivable | 11,407,969 | 772,893 | 12,180,862 |
| Total current assets | 139,120,949 | 17,305,697 | 156,426,646 |
| Loans receivable, net of current portion | 135,065,436 | 13,038,017 | 148,103,453 |
| Property and equipment, net of accumulated depreciation, at cost | - | 213,255 | 213,255 |
| Total assets | <u>\$ 274,186,385</u> | <u>\$ 30,556,969</u> | <u>\$ 304,743,354</u> |
| Liabilities | | | |
| Current liabilities | | | |
| Accrued payroll and other | \$ 59,655 | \$ 64,780 | \$ 124,435 |
| Total liabilities | 59,655 | 64,780 | 124,435 |
| Net Assets | | | |
| Invested capital assets | - | 213,255 | 213,255 |
| Restricted | 274,126,730 | 30,278,934 | 304,405,664 |
| Total net assets | 274,126,730 | 30,492,189 | 304,618,919 |
| Total liabilities and net assets | <u>\$ 274,186,385</u> | <u>\$ 30,556,969</u> | <u>\$ 304,743,354</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Statement of Revenues, Expenses and Changes in Fund Net Assets —
Proprietary Funds
Year Ended June 30, 2005

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|------------------------------|---|---|-----------------------|
| Operating revenues | | | |
| Interest income from loans | \$ 3,723,536 | \$ 181,344 | \$ 3,904,880 |
| Administration loan fee | 1,508,779 | 437,045 | 1,945,824 |
| Total revenues | 5,232,315 | 618,389 | 5,850,704 |
| Expenses | | | |
| Administrative | 1,122,089 | 343,695 | 1,465,784 |
| State program management | - | 414,796 | 414,796 |
| Water protection | - | 203,680 | 203,680 |
| Small systems | - | 97,500 | 97,500 |
| Total expenses | 1,122,089 | 1,059,671 | 2,181,760 |
| Operating income (loss) | 4,110,226 | (441,282) | 3,668,944 |
| Nonoperating revenues | | | |
| State contributions | 2,086,000 | 1,611,000 | 3,697,000 |
| Federal contributions | 1,207,069 | 1,425,039 | 2,632,108 |
| Other interest income | 3,368,836 | 364,214 | 3,733,050 |
| Other | - | 240 | 240 |
| Total nonoperating revenues | 6,661,905 | 3,400,493 | 10,062,398 |
| Change in net assets | 10,772,131 | 2,959,211 | 13,731,342 |
| Net assets at July 1, 2004 | 263,354,599 | 27,532,978 | 290,887,577 |
| Net assets at June 30, 2005 | <u>\$ 274,126,730</u> | <u>\$ 30,492,189</u> | <u>\$ 304,618,919</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Statement of Cash Flows — Proprietary Funds
Year Ended June 30, 2005

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|---|---|---|-----------------------|
| Cash flows from operating activities | | | |
| Interest income from loans | \$ 3,827,629 | \$ 181,382 | \$ 4,009,011 |
| Administrative loan fees | 1,512,272 | 436,054 | 1,948,326 |
| Principal repayments on loans | 11,006,814 | 730,131 | 11,736,945 |
| Disbursement of loan proceeds | (2,028,921) | (941,992) | (2,970,913) |
| Payment to employees | (973,811) | (318,594) | (1,292,405) |
| Payments to vendors | (121,645) | (612,345) | (733,990) |
| Net cash flows provided by (used in) operating activities | 13,222,338 | (525,364) | 12,696,974 |
| Cash flows from noncapital financing activities | | | |
| Federal contributions | 1,203,263 | 1,283,844 | 2,487,107 |
| State contributions | 2,086,000 | 1,611,000 | 3,697,000 |
| Other income | - | 240 | 240 |
| Net advances to other funds | - | (55,000) | (55,000) |
| Net cash flows provided by noncapital financing activities | 3,289,263 | 2,840,084 | 6,129,347 |
| Cash flows from capital and related financing activities | | | |
| Purchase of equipment | - | (31,132) | (31,132) |
| Net cash flows used in capital and related financing activities | - | (31,132) | (31,132) |
| Cash flows from investing activities | | | |
| Other interest | 3,112,188 | 335,728 | 3,447,916 |
| Net cash flows provided by investing activities | 3,112,188 | 335,728 | 3,447,916 |
| Net increase in cash and cash equivalents | 19,623,789 | 2,619,316 | 22,243,105 |
| Cash and cash equivalents at July 1, 2004 | 105,894,017 | 12,108,106 | 118,002,123 |
| Cash and cash equivalents at June 30, 2005 | <u>\$ 125,517,806</u> | <u>\$ 14,727,422</u> | <u>\$ 140,245,228</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Statement of Cash Flows — Proprietary Funds
Year Ended June 30, 2005

| | Water Pollution Control Revolving Fund | Drinking Water Treatment Revolving Loan Fund | Total |
|---|--|---|----------------------|
| Reconciliation of operating income to net cash provided by (used in) operating activities | | | |
| Operating income (loss) | \$ 4,110,226 | \$ (441,282) | \$ 3,668,944 |
| Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities | | | |
| Depreciation expense | 14,267 | 166,356 | 180,623 |
| Other | (5,600) | (89,581) | (95,181) |
| Change in assets and liabilities | | | |
| Loan receivable | 8,977,893 | (211,861) | 8,766,032 |
| Accrued interest on loans receivables | 104,094 | 38 | 104,132 |
| Loan fees receivable | 3,493 | (991) | 2,502 |
| Accrued wages and other | 17,965 | 51,957 | 69,922 |
| Net cash provided by (used in) operating activities | <u>\$ 13,222,338</u> | <u>\$ (525,364)</u> | <u>\$ 12,696,974</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Statement of Fiduciary Net Assets — Fiduciary Funds
June 30, 2005

| | Agency Funds |
|---------------------------|-------------------------|
| Assets | |
| Cash and cash equivalents | <u>\$ 331,418</u> |
| Total assets | <u>\$ 331,418</u> |
| Liabilities | |
| Due to others | <u>\$ 331,418</u> |
| Total liabilities | <u>\$ 331,418</u> |

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Notes to Financial Statements
June 30, 2005

1. Organization and Summary of Significant Accounting Policies

Financial Reporting Entity

The State of Hawaii, Department of Health (the Department), administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment and the enforcement of environmental health laws. Federal grants received to support the State's health services and programs are administered by the Department.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB).

The Department is part of the executive branch of the State of Hawaii (the State). The financial statements of the State of Hawaii, Department of Health are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2005, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America. The State Comptroller maintains the central accounts for all State funds and publishes a comprehensive annual financial report for the State annually, which includes the Department's financial activities.

Act 262, Session Laws of Hawaii of 1996, established the Hawaii Health Systems Corporation ("HHSC") as a public body corporate and politic and an instrumentality and agency of the State. HHSC consists of the state hospitals and was created to provide quality health care for all of the people in the state. HHSC commenced operations on July 1, 1996 and is administratively attached to the Department. However, HHSC is a component unit of the State and not the Department. HHSC's stand-alone financial statements are included in the State's comprehensive annual financial report but not included in the Department's basic financial statements.

Department-wide Financial Statements

The Department-wide financial statements, the statement of net assets and the statement of activities, are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Expenditures generally are recorded when

State of Hawaii
Department of Health
Notes to Financial Statements
June 30, 2005

a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

The proprietary funds and fiduciary funds financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the department-wide financial statements described above.

The Department has the option under GASB Statement 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, to elect to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The Department's enterprise funds have elected not to apply FASB statements after the applicable date.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

A description of the funds administered by the Department is as follows:

Governmental Funds (Governmental Activities):

- *General Fund* — The General Fund is the general operating fund of the Department. It is used to account for all financial resources except those required to be accounted for in another fund. The General Fund presented is a part of the State's General Fund and is limited to only those appropriations and obligations of the Department.
- *Special Revenue Funds* — Special revenue funds are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specified purposes.
- *Capital Projects Funds* — Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary fund type), which are included in Other Funds in the fund financial statements.

Proprietary Funds (Business-Type Activities):

- *Enterprise Funds* — Enterprise funds are used to account for the activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to customers, or where sound financial management dictates that periodic determination of results of operations are appropriate.

Fiduciary Funds:

- *Agency Funds* — Agency funds are used to account for cash collected and expended by the Department in a custodial capacity.

State of Hawaii
Department of Health
Notes to Financial Statements
June 30, 2005

Equity in Cash and Cash Equivalents in State Treasury

The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that the depository banks pledge as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

Effective in fiscal 2005, the State was required to implement the disclosure requirements of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* ("Statement No. 40"). Statement No. 40 requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit and custodial risk assumed by the Department. However, as all of the Department's monies are held in the State cash pool, the Department does not manage its own investments and the types of investments and related interest rate, credit, and custodial risks are not determinable at the Department level. The risk disclosures of the State's cash pool are included in the State's Comprehensive Annual Financial Report ("CAFR") for the fiscal year ended June 30, 2005 which may be obtained from the following address:

Department of Accounting and General Services
Accounting Division
P.O. Box 119
Honolulu, Hawaii 96810-0119

Tobacco Settlement

In November 1998, the State settled its tobacco lawsuit as part of a nationwide settlement involving 46 other states and various tobacco industry defendants. Under the settlement, those tobacco companies that have joined in the Master Settlement Agreement will pay the State approximately \$1.3 billion over a 25-year period. The Department is responsible for administering the Hawaii Tobacco Settlement Special Fund. The Department receives all tobacco settlement monies and then allocates and appropriates 75% of the funds to other State agencies/departments in accordance with Hawaii Revised Statutes ("HRS") 328L-2. The Department receives annual payments on April 15 of each year for tobacco settlements earned for the preceding calendar year.

The Department received \$38,009,000 in tobacco settlement proceeds during the year ended June 30, 2005 for the calendar year ended December 31, 2004. In accordance with GASB Technical Bulletin No. 04-01, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the Department has recorded a tobacco settlement receivable for \$18,700,000 in the statement of net assets representing tobacco settlements earned for the period January 1, 2005 through June 30, 2005.

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Reserved for Encumbrances

Encumbrance accounting, under which purchase orders and contractual commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the governmental funds. Although appropriations lapse at year end, open encumbrances are reported as reservations of fund balances because the commitments will be honored when the goods or services are received. Encumbrances do not constitute expenditures or liabilities.

Capital Assets

Capital assets, which include buildings, furniture, and equipment, are reported in the applicable governmental or business-type activities in the department-wide financial statements and in the proprietary financial statements. Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

| | |
|------------------------------------|-----------------|
| Land | All capitalized |
| Land improvements | \$100,000 |
| Building and building improvements | \$100,000 |
| Equipment | \$ 5,000 |

Such assets are recorded at historical cost if purchased or constructed. Donated assets are recorded at estimated fair market value at the time received. Depreciation expense is recorded in the department-wide financial statements using the straight-line method over the estimated useful lives of the assets. Generally, the useful lives are as follows:

| | Governmental- Type Activities | Proprietary Fund and Business- Type Activities |
|------------------------------------|--|---|
| Land improvements | 15 | Not applicable |
| Building and building improvements | 30 | Not applicable |
| Furniture and equipment | 5—7 | 5—7 |

Deferred Revenues

Deferred revenues at the fund level and department-wide level arise when the Department receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the Department has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and balance sheet, and revenue is recognized. Deferred revenues at June 30, 2005 consist primarily of Federal grant funds for which all eligibility requirements have not been met.

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Accrued Vacation

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

Intrafund and Interfund Transactions

Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them are recorded as operating transfers in the basic financial statements.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2004. Management does not believe this Statement will have a material effect on its financial statements.

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postretirement Benefits Other Than Pension Plans*. This Statement establishes uniform standards of financial reporting by state and local governmental entities for other post employment benefit plans ("OPEB plans"). OPEBs refer to post employment benefits other than pensions. The provisions of this Statement are effective for the State of Hawaii for the fiscal year beginning after December 15, 2005. Management has not yet determined the effect this Statement will have on its financial statements. The Department participates in the State's plan. The costs and benefits of the plan will be allocated at the State level. The Department will record the amounts allocated to it.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition and display of other postretirement benefits expense/expenditures and related liabilities (assets), note disclosures and required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management has not yet determined the effect this Statement will have on its financial statements.

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Department of Health
Notes to Financial Statements
June 30, 2005

2. Restatements to the Department-wide Net Assets and Governmental Funds Fund Balances

The financial statements as of and for the year ended June 30, 2004, not presented herein, were audited by other independent auditors, whose report dated March 14, 2005 expressed an unqualified opinion on those financial statements. The Department has restated its June 30, 2004 department-wide net asset and governmental funds fund balances to correct errors in accounting for cash, accrued tobacco settlement revenues, capital assets, vouchers and contracts payable, accrued wages and employee benefits payable, and accrued vacation balances. The restatement adjustments were made to correct the following accounting errors: a) record cash balances of the Department that were not properly reported at June 30, 2004, b) record liabilities that were not properly accrued at June 30, 2004, c) correct the calculation of accrued payroll and vacation, d) record capital assets placed in service in fiscal year 2002 that were not previously recorded, e) accrue revenue related to the Deposit Beverage Container Fund earned in fiscal year 2004 that was not accrued at that date, f) accrue tobacco settlements related to the Hawaii Tobacco Settlement Special Fund at June 30, 2004, and g) properly report a special revenue fund improperly classified as a fiduciary fund at June 30, 2004.

As a result of these corrections, the Department made the following adjustments to its previously reported June 30, 2004 department-wide net assets and governmental funds fund balances.

| | Governmental Activities |
|--|------------------------------------|
| Net assets at June 30, 2004, as previously reported | \$ 145,391,469 |
| Adjustment for unrecorded vouchers and contracts payable | (15,293,396) |
| Adjustment to properly state accrued wages and employee benefits payable | (807,104) |
| Adjustment to properly state accrued vacation | 2,147,481 |
| Adjustment for unrecorded capital assets | 5,706,266 |
| Adjustment to properly state revenue | 582,724 |
| Adjustment to properly state special revenue funds fund balances | 53,572 |
| Adjustment to properly state cash | 1,233,077 |
| Adjustment for tobacco settlement receivable | 4,550,000 |
| Net assets at June 30, 2004, as restated | <u>\$ 143,564,089</u> |

State of Hawaii
Department of Health
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| | Governmental Funds |
|--|-------------------------------|
| Fund balances at June 30, 2004, as previously reported | \$ 98,149,227 |
| Adjustment for unrecorded vouchers and contracts payable | (15,293,396) |
| Adjustment to properly state accrued wages and employee benefits payable | (807,104) |
| Adjustment to properly state revenue | 582,724 |
| Adjustment to properly state special revenue funds fund balances | 53,572 |
| Adjustment to properly state cash | 1,233,077 |
| Fund balances at June 30, 2004, as restated | <u>\$ 83,918,100</u> |

As the prior period financial statements have not been presented herein, the restatements have been effected as adjustments to the opening department-wide net assets and governmental funds fund balances. These adjustments were audited in connection with the audit of the June 30, 2005 financial statements.

3. Loans Receivable

At June 30, 2005, the proprietary funds loans receivable consist of loans to county governmental units for the water pollution control and drinking water treatment programs. The loans are due in annual, semi-annual or quarterly payments, including interest at 0.46% to 3.02%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. Accrued interest receivable on the loans amounted to approximately \$1,330,746 at June 30, 2005.

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2005:

| | |
|-----------------------------|-----------------------|
| Year ending June 30, | |
| 2006 | \$ 12,180,862 |
| 2007 | 12,479,154 |
| 2008 | 12,779,835 |
| 2009 | 13,092,916 |
| 2010 | 13,408,923 |
| Thereafter | 96,342,625 |
| | <u>\$ 160,284,315</u> |

State of Hawaii
Department of Health
Notes to Financial Statements
June 30, 2005

4. Capital Assets

Capital asset activity for the year ended June 30, 2005 was as follows:

| | Beginning Balance As Restated | Additions | Dispositions | Ending Balance |
|--|-------------------------------------|----------------|--------------|----------------|
| Government activities | | | | |
| Capital assets, not being depreciated | | | | |
| Land | \$ 1,018,080 | \$ - | \$ - | \$ 1,018,080 |
| Total capital assets not being depreciated | 1,018,080 | - | - | 1,018,080 |
| Capital assets, being depreciated | | | | |
| Land improvements | 1,862,927 | - | - | 1,862,927 |
| Building and improvements | 131,292,874 | 875,610 | - | 132,168,484 |
| Furniture and equipment | 14,114,968 | 1,089,547 | (625,988) | 14,578,527 |
| Total capital assets being depreciated | 147,270,769 | 1,965,157 | (625,988) | 148,609,938 |
| Less accumulated depreciation | | | | |
| Land improvements | 1,705,803 | 76,160 | - | 1,781,963 |
| Building and improvements | 60,668,459 | 4,035,869 | - | 64,704,328 |
| Furniture and equipment | 10,308,981 | 1,022,519 | (309,953) | 11,021,547 |
| Total accumulated depreciation | 72,683,243 | 5,134,548 | (309,953) | 77,507,838 |
| Government activities, net | \$ 75,605,606 | \$ (3,169,391) | \$ (316,035) | \$ 72,120,180 |
| Business-type activities | | | | |
| Capital assets being depreciated | | | | |
| Equipment | \$ 622,353 | \$ 144,687 | \$ (18,367) | \$ 748,673 |
| Total capital assets being depreciated | 622,353 | 144,687 | (18,367) | 748,673 |
| Less accumulated depreciation for | | | | |
| Equipment | 373,162 | 180,623 | (18,367) | 535,418 |
| Total accumulated depreciation | 373,162 | 180,623 | (18,367) | 535,418 |
| Business-type activities capital assets, net | \$ 249,191 | \$ (35,936) | \$ - | \$ 213,255 |

Current period depreciation expense was charged to functions as follows:

| | |
|---|--------------|
| Government activities | |
| General administration | \$ 487,101 |
| Environmental health | 1,752,299 |
| Behavioral health | 1,765,308 |
| Health resources | 1,129,840 |
| Total depreciation expense — governmental activities | \$ 5,134,548 |
| Business-type activities | |
| Environmental health | \$ 180,623 |
| Total depreciation expense — business-type activities | \$ 180,623 |

State of Hawaii
Department of Health
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June 30, 2005

5. Long-Term Obligation — Governmental Activities

The changes to the accrued vacation liability as of June 30, 2005 are as follows:

| | |
|--------------------------------------|----------------------|
| Balance at July 1, 2004, as restated | \$ 19,894,690 |
| Increase | 10,481,578 |
| Decrease | <u>7,580,214</u> |
| Balance at June 30, 2005 | 22,796,054 |
| Less current portion | <u>7,709,625</u> |
| | <u>\$ 15,086,429</u> |

6. Non-Imposed Employee Fringe Benefits

Non-imposed employee fringe benefits related to General Fund salaries are assumed by the State and are not charged to the Department. These costs, totaling approximately \$35,931,154 for the fiscal year ended June 30, 2005, have been reported as revenues and expenditures of the Department's General Fund.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the Special Revenue Funds.

7. Employee Benefits

Employees' Retirement System

Substantially all eligible employees of the Department are members of the Employee's Retirement System of the State of Hawaii ("ERS"), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

The ERS is composed of a contributory retirement option and a noncontributory retirement option. Prior to July 1, 1984, the ERS consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee's age, years of credited service and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003, is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation

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Notes to Financial Statements
June 30, 2005

months plus lump sum vacation payment. Contributions for employees of the Department are paid from the State general fund and are included as part of the non-imposed fringe benefit costs discussed in Note 6.

Most covered employees of the contributory option are required to contribute 7.8 percent of their salary. The funding method used to calculate the total employer contribution requirement is the entry age normal actuarial cost method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the remaining period of 29 years from July 1, 2000.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits, and other aspects of the ERS, is also not available on a departmental or agency basis.

ERS issues a CAFR that includes financial statements and required supplementary information which may be obtained from the following address:

Employee's Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813

Post-retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to Chapter 87, HRS, provides certain health care and life insurance benefits to all qualified employees. For employees hired before July 1, 1996, the State pays the entire monthly health care premium for those retiring with ten or more years of credited service, and 50 percent of the monthly premium for those retiring with fewer than ten years of credited service. For employees hired after June 30, 1996, and retiring with fewer than ten years of service, the State makes no contributions. For those retiring with at least ten years but fewer than 15 years of service, the State pays 50 percent of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and retiring with at least 15 years but fewer than 25 years of service, the State pays 75 percent of the retired employees' monthly Medicare or non-Medicare premium; and for those retiring with over 25 years of service, the State pays the entire health care premium. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement for the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis.

Effective July 1, 2003, the EUTF replaced the Hawaii Public Employees Health Fund under Act 88, SLH 2001. The EUTF was established to provide a single delivery system of health benefits to state and county employees, retirees, and their dependants.

Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service good standing with 60 days or more of unused sick leave is entitled to additional service credit in ERS. At June 30, 2005, accumulated sick leave was approximately \$61,123,671.

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Department of Health
Notes to Financial Statements
June 30, 2005

Deferred Compensation Plan

The State established a deferred compensation plan ("Plan") in accordance with Section 457 of the Internal Revenue Code, which enable State employees to defer a portion of their compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, as well as property and rights purchased with those amounts and income attributable to these amounts are held in trust by third party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the Plan are not reflected in the State of Hawaii or Department financial statements.

Commitments and Contingencies

Operating Leases

The Department leases various office facilities and equipment on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rentals on noncancelable operating leases at June 30, 2005:

| Year ending June 30, | |
|-----------------------------|---------------------|
| 2006 | \$ 1,050,100 |
| 2007 | 703,000 |
| 2008 | 239,100 |
| 2009 | 112,200 |
| 2010 | 83,700 |
| Thereafter | 18,500 |
| | <u>\$ 2,206,600</u> |

Rent expenditures for the fiscal year ended June 30, 2005 approximated \$2.2 million.

Insurance Coverage

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2005, the State recorded an estimated loss for workers' compensation, automobile and general liability claims as long-term debt as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's general fund. The Department's portion of the State's workers' compensation expense for the year ended June 30, 2005 was approximately \$586,000.

Litigation

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's general fund.

State of Hawaii
Department of Health
Notes to Financial Statements
June 30, 2005

Ceded Lands

The Office of Hawaiian Affairs (OHA) and the State of Hawaii are presently in litigation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. As of June 30, 2005, the outcome of the lawsuit had not been decided.

**REQUIRED SUPPLEMENTARY INFORMATION
OTHER THAN MANAGEMENT'S DISCUSSION
AND ANALYSIS**

State of Hawaii
Department of Health
Budgetary Comparison Schedule — General Fund
Year Ended June 30, 2005

| | Budgeted Amounts | | Actual Amounts (Budgetary Basis) (see Note) |
|---|-------------------------|----------------|--|
| | Original | Final | |
| Revenues | | | |
| Current-year appropriations | \$ 377,168,671 | \$ 382,189,805 | \$ 380,050,066 |
| Total revenues | 377,168,671 | 382,189,805 | 380,050,066 |
| Expenditures | | | |
| General administration | 16,494,109 | 16,767,033 | 16,504,471 |
| Environmental health administration | 16,710,578 | 16,926,049 | 16,766,149 |
| Behavioral health services administration | 178,470,861 | 180,452,801 | 179,492,136 |
| Health resources administration | 165,493,123 | 168,043,922 | 167,287,310 |
| Total expenditures | 377,168,671 | 382,189,805 | 380,050,066 |
| Excess of revenues over expenditures | \$ - | \$ - | \$ - |

State of Hawaii
Department of Health
Budgetary Comparison Schedule — Tobacco Settlement Fund
Year Ended June 30, 2005

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts (Budgetary Basis) (see Note)</u> |
|--------------------------------------|-------------------------|----------------------|--|
| | <u>Original</u> | <u>Final</u> | |
| Revenues | | | |
| Current-year funds | <u>\$ 50,342,603</u> | <u>\$ 50,358,223</u> | <u>\$ 38,559,650</u> |
| Total revenues | <u>50,342,603</u> | <u>50,358,223</u> | <u>38,559,650</u> |
| Expenditures | | | |
| Environmental health administration | <u>50,342,603</u> | <u>50,358,223</u> | <u>39,491,611</u> |
| Total expenditures | <u>50,342,603</u> | <u>50,358,223</u> | <u>39,491,611</u> |
| Excess of expenditures over revenues | <u>\$ -</u> | <u>\$ -</u> | <u>\$ (931,961)</u> |

State of Hawaii
Department of Health
Budgetary Comparison Schedule — Deposit Beverage Container Fund
Year Ended June 30, 2005

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> <u>(Budgetary Basis)</u> <u>(see Note)</u> |
|--------------------------------------|-------------------------|---------------|--|
| | <u>Original</u> | <u>Final</u> | |
| Revenues | | | |
| Current-year funds | \$ 22,026,250 | \$ 22,026,250 | \$ 29,442,460 |
| Total revenues | 22,026,250 | 22,026,250 | 29,442,460 |
| Expenditures | | | |
| Health resources administration | 22,026,250 | \$ 22,026,250 | 21,804,897 |
| Total expenditures | 22,026,250 | 22,026,250 | 21,804,897 |
| Excess of revenues over expenditures | \$ - | \$ - | \$ 7,637,563 |

State of Hawaii
Department of Health
Notes to Required Supplementary Information
Year Ended June 30, 2005

1. Budgeting and Budgetary Control

The Department follows these procedures in establishing the budgetary data reflected in the basic financial statements:

- *The Budget* — Not less than 20 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendation of the Governor for the succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress; and an estimate for the succeeding biennium.
- *Legislative Review* — The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances as will assist in determining the State's program and financial plan and budget.
- *Program Execution* — Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts.

Budgets are adopted for the General Fund of the Department and are prepared on the basis of cash receipts and amounts disbursed, which is a basis of accounting other than generally accepted accounting principles ("GAAP").

The major difference between the budgetary and GAAP basis are that: (1) the budget is prepared on the basis of cash receipts and amounts disbursed; and (2) encumbrances are recorded as the equivalent of expenditures under the budgetary basis.

Since budgetary basis differs from GAAP, budget and actual amounts in the accompanying Required Supplementary Information – Budgetary Schedules are presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures and other financing sources (uses) on a budgetary basis at June 30, 2005, to revenues in excess of (less than) expenditures and other financing sources (uses) presented in conformity with GAAP is set forth in the Notes to the Required Supplementary Information.

State of Hawaii
Department of Health
Notes to Required Supplementary Information
Year Ended June 30, 2005

2. Explanation of Differences between Budgetary Actual and GAAP Revenues and Expenditures

| | General Fund | Tobacco Settlement Fund | Deposit Beverage Container Fund |
|--|-------------------------|--|--|
| Excess of expenditures over revenues and other sources and uses — actual on a budgetary basis | \$ - | \$ (931,961) | \$ 7,637,563 |
| Reserve for encumbrances at year end | 40,648,343 | 7,032,050 | 10,048,704 |
| Expenditures for liquidation of prior year's encumbrances | (38,139,480) | (6,856,516) | - |
| Accrual and other adjustments | 134,984 | 1,948,254 | (8,289,264) |
| Excess of revenues over expenditures — GAAP basis | <u>\$ 2,643,847</u> | <u>\$ 1,191,827</u> | <u>\$ 9,397,003</u> |

**Schedule of
Expenditures of Federal Awards**

State of Hawaii
Department of Health
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2005

| Federal Grantor/Pass-Through Grantor/Program Title | Project Number | CFDA Contract, Award or Assistance ID Number | Federal Expenditures | Amount Provided to Subrecipient |
|--|----------------|--|----------------------|---------------------------------|
| U.S. Department of Health and Human Services (DHHS) | | | | |
| Direct Programs | | | | |
| Public Health and Social Services Emergency Fund | 435 | 93.003 | \$ 1,785,237 | \$ 1,760,942 |
| Special Programs for Aging -- Title VII Chapter 3 | 468 | 93.041 | 17,354 | - |
| Special Programs for Aging -- Title VII Chapter 2 | 468 | 93.042 | 72,310 | - |
| Special Programs for Aging -- Title III Part D | 401 | 93.043 | 100,214 | 100,214 |
| Special Programs for Aging -- Title III Part B | 401 | 93.044 | 2,470,110 | 2,429,371 |
| Special Programs for Aging -- Title III Part C1 & C2 | 401 | 93.045 | 2,331,830 | 1,893,045 |
| Nutrition Services Incentive Program | 406 | 93.053 | 478,509 | 478,509 |
| Subtotal Aging Cluster | | | 5,280,449 | |
| Special Programs for Aging -- Title IV | 405 | 93.048 | 131,966 | - |
| Special Programs for Aging -- Title III Part E | 401 | 93.052 | 697,843 | 697,843 |
| Maternal and Child Health Federal Consolidated Programs | various | 93.110 | 592,880 | 163,694 |
| Project Grants and Cooperative Agreements for Tuberculosis Control Programs | 247 | 93.116 | 962,872 | - |
| Emergency Medical Services for Children | 388 | 93.127 | 112,569 | - |
| Primary Care Services -- Resource Coordination and Development | 298 | 93.130 | 90,163 | - |
| Injury Prevention and Control Research and State and Community Based Programs | various | 93.136 | 207,284 | 45,000 |
| Projects for Assistance in Transition from Homelessness (PATH) | various | 93.150 | 376,777 | 376,777 |
| Family Planning -- Services | 239 | 93.217 | 1,695,162 | 920,988 |
| Consolidated Knowledge Development and Application Program | various | 93.230 | 1,965,440 | - |
| Traumatic Brain Injury State Demonstration Grant Program | 434 | 93.234 | 183,896 | - |
| Abstinence Education Initiative | 273 | 93.235 | 88,988 | 50,368 |
| Cooperative agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement | various | 93.238 | 292,750 | 226,700 |
| Rural Hospital Flexibility Program | 415 | 93.241 | 300,714 | - |
| Substance Abuse and Mental Health Services | various | 93.243 | 1,083,592 | - |
| Universal Newborn Hearing Screening | 416 | 93.251 | 130,325 | - |
| State Planning Grants Health Care Access for the Uninsured | various | 93.256 | 357,149 | 74,919 |
| Rural Access to Emergency Devices | 453 | 93.259 | 185,509 | 185,509 |
| Immunization Grants | various | 93.268 | 2,986,906 | 62,280 |
| Centers for Disease Control and Prevention | various | 93.283 | 12,886,437 | 1,457,997 |
| Small Rural Hospital Improvement | 454 | 93.301 | (1,595) | - |
| Child Care and Development Block Grant | 244 | 93.575 | 175,061 | 97,907 |
| Community-Based Family Resource and Support Grants | 270 | 93.590 | 574,016 | - |
| Development Disabilities Basic Support and Advocacy Grants | 240 | 93.630 | 492,249 | 53,489 |
| Family Support Demonstration | 445 | 93.631 | 27,845 | 27,846 |
| State Survey and Certification of Health Care Providers and Suppliers | various | 93.777 | 1,280,472 | - |
| Centers for Medicare and Medicaid Services Research, Demonstrations and Evaluations | various | 93.779 | 377,357 | - |
| Grants to States for Operation of Offices of Rural Health | 299 | 93.913 | 79,944 | - |
| HIV Care Formula Grants | 293 | 93.917 | 3,323,349 | 1,096,436 |
| Comprehensive Breast & Cervical Cancer Early Detection Program | 348 | 93.919 | 886 | 42,197 |
| Healthy Start Initiative | various | 93.926 | 905,003 | - |
| HIV / AIDS Surveillance | various | 93.944 | 2,210,264 | 940,000 |
| Improving Contact Investigations in Foreign Born Populations | 427 | 93.947 | 3,966 | - |
| Block Grants for Community Mental Health Services | various | 93.958 | 1,253,380 | 1,072,551 |
| Substance Abuse Prevention and Treatment Block Grant | various | 93.959 | 6,993,187 | 5,465,297 |
| Preventive Health Services -- Sexually Transmitted Diseases Control Grants | 268 | 93.977 | 397,817 | - |
| Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance System | 261 | 93.988 | 325,572 | - |
| Preventive Health and Health Services Block Grant | various | 93.991 | 884,105 | 17,000 |
| Maternal and Child Health Services Block Grant | various | 93.994 | 2,547,813 | 26,022 |
| Vital Statistics Cooperative Program | 285 | 200-89-7211 | 97,064 | - |
| Hansen's Disease National Ambulatory Care | 264 | 93. | 550,475 | - |
| Drug and Alcohol Services Information System | 371 | 93. | 35,312 | - |
| Other | 475 | 93. | 28,345 | - |
| Subtotal Direct Programs | | | 55,146,673 | 19,762,901 |
| Pass-through from the Commonwealth of Kentucky | | | | |
| Medicare, Pacific Area | 384 | Not Available | 48,163 | - |
| Medicare, OASIS | 387 | Not Available | 4 | - |
| Subtotal Pass-through from the Commonwealth of Kentucky | | | 48,167 | - |
| Total Department of Health and Human Services | | | 55,194,840 | 19,762,901 |

State of Hawaii
Department of Health
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2005

| Federal Grantor/Pass-Through Grantor/Program Title | Project Number | CFDA Contract, Award or Assistance ID Number | Federal Expenditures | Amount Provided to Subrecipient |
|---|----------------|--|----------------------|---------------------------------|
| U.S. Department of Agriculture | | | | |
| Direct Program | | | | |
| Special Supplemental Nutrition Program for Women, Infants, and Children | 275 | 10.557 | \$ 29,593,068 | \$ 2,038,404 |
| Total Department of Agriculture | | | <u>29,593,068</u> | <u>2,038,404</u> |
| Environmental Protection Agency (EPA) | | | | |
| Direct Program | | | | |
| Air Pollution Control Program Support | 233 | 66.001 | 632,132 | - |
| Surveys, Studies, Investigations, Demonstrations and Special Purpose | | | | |
| Activities Relating to the Clean Air Act | various | 66.034 | 98,930 | - |
| Water Pollution Control – State and Interstate Program Support | various | 66.419 | 1,955,059 | - |
| State Public Water System Supervision | 232 | 66.432 | 448,300 | - |
| Water Quality Management Program | 10284-11284 | 66.454 | 107,885 | - |
| Capitalization Grants for State Revolving Funds | 4206-15206 | 66.458 | 1,207,069 | 1,203,263 |
| Nonpoint Source Implementation Grants | 3290-7289 | 66.460 | 1,691,232 | - |
| Water Quality Cooperative Agreements | 256 | 66.463 | 1,384 | - |
| Beach Monitoring and Notification Program | 431 | 66.472 | 161,684 | - |
| Water Protection Coordination | 449 | 66.474 | 15,373 | - |
| Capitalization Grants for Drinking Water State Revolving Fund | 1207-7207 | 66.468 | 1,427,470 | 807,529 |
| Water Infrastructure Oversight | 294 | 66.606 | 4,918 | - |
| Environmental Information Exchange Grant Program | 467 | 66.608 | 205,969 | 208,867 |
| Toxic Substances Compliance Monitoring Cooperative Agreements | 243 | 66.701 | 120,377 | - |
| TSCA Title IV State Lead Grants | 330 | 66.707 | 92,562 | - |
| Multi-Media Capacity Building Grants for States and Tribes | 462 | 66.709 | 25,852 | - |
| Hazardous Waste Management State Program Support | 230 | 66.801 | 521,734 | - |
| Superfund State Site Specific Cooperative Agreements | various | 66.802 | 503,803 | 155,233 |
| State Underground Storage Tanks Program (UST Program) | 220 | 66.804 | 147,663 | - |
| Leaking Underground Storage Tank (LUST) Trust Fund Program | 258 | 66.805 | 401,806 | - |
| State Response Program Grants | 469 | 66.817 | 487,095 | - |
| Other | various | 66. | 107 | - |
| Total Environmental Protection Agency | | | <u>10,258,405</u> | <u>2,374,892</u> |
| U.S. Department of Education | | | | |
| Direct Program | | | | |
| Grants for Infants and toddlers with Disabilities | 213 | 84.181 | 2,063,106 | 478,125 |
| State Improvement Grant – Early Intervention | 441 | 84. | (6,770) | - |
| Total Department of Education | | | <u>2,056,336</u> | <u>478,125</u> |
| U.S. Department of Defense | | | | |
| Direct Program | | | | |
| Defense Environmental Restoration Program | 245 | 12.113 | 183,367 | - |
| Total Department of Defense | | | <u>183,367</u> | <u>-</u> |
| U.S. Department of Justice | | | | |
| Direct Program | | | | |
| Enforcing Underage Drinking Laws Program | various | 16.727 | 643,363 | 639 |
| Total Department of Justice | | | <u>643,363</u> | <u>639</u> |
| U.S. Department of Transportation | | | | |
| Direct Program | | | | |
| Underage Drinking Prevention | 473 | 20. | 76,892 | - |
| Highway Safety Grants | 476 | 20. | 157,150 | 140,325 |
| Total Department of Transportation | | | <u>234,042</u> | <u>140,325</u> |
| U.S. Department of Homeland Security | | | | |
| Direct Program | | | | |
| Other | 470 | 97. | 73,496 | - |
| Total Department of Transportation | | | <u>73,496</u> | <u>-</u> |
| Oregon Health and Science University | | | | |
| Direct Program | | | | |
| Hawaii NFATTC | 432 | Not Available | 31,227 | - |
| Total Oregon Health and Science University | | | <u>31,227</u> | <u>-</u> |
| Total Expenditures of Federal Awards | | | <u>\$ 98,268,143</u> | <u>\$ 24,795,286</u> |

State of Hawaii
Department of Health
Notes to the Schedule of Expenditures of Federal Awards
June 30, 2005

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the State of Hawaii, Department of Health (the "Department"), and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Loans Outstanding

The Department had the following loan balances outstanding at June 30, 2005. Loans made during the year are included in the federal expenditures presented in the schedule of expenditures of federal awards.

| Program Title | Federal CFDA Number | Amount Outstanding |
|--|--------------------------------|-------------------------------|
| Capitalization Grants for State Revolving Funds | 66.458 | \$ 120,178,108 |
| Capitalization Grants for Drinking Water State Revolving Fund | 66.468 | 13,810,910 |

PART II

GOVERNMENT AUDITING STANDARDS

**Report of Independent Auditors on Internal Control Over
Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Auditor
State of Hawaii

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (the "Department") as of and for the year ended June 30, 2005, which collectively comprise the Department's basic financial statements and have issued our report thereon dated June 15, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs as Finding No. 05-01.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider Finding No. 05-01 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Department in a separate letter dated June 15, 2006.

This report is intended solely for the information and use of the State Auditor, the Department's management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

PricewaterhouseCoopers LLP

Honolulu, Hawaii
June 15, 2006

PART III

OMB Circular A-133

**Report of Independent Auditors on Compliance with Requirements
Applicable to Each Major Program and on Internal Control Over Compliance
in Accordance with OMB Circular A-133**

The Auditor
State of Hawaii

Compliance

We have audited the compliance of the State of Hawaii, Department of Health with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

As described in Finding Nos. 05-02 and 05-03 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding Eligibility and Reporting that are applicable to its HIV Care Formula Grant Program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

As described in Finding No. 05-05, we were unable to obtain sufficient documentation supporting the compliance of the Department with requirements regarding Eligibility that are applicable to its Centers for Disease Control and Prevention Program, nor were we able to satisfy ourselves as to the Department's compliance with those requirements by other auditing procedures.

In our opinion, except for the noncompliance described above regarding the Department's compliance with the requirements of the HIV Care Formula Grant Program regarding Eligibility and Reporting, and the effects of such noncompliance described above, if any, as might have been determined had we been able to examine sufficient evidence regarding the Department's compliance with the requirements of the Centers for Disease Control and Prevention Program regarding Eligibility, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005. In addition, the results of our auditing procedures disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Finding Nos. 05-04 and 05-06 through 05-18. We also noted certain other matters that we have reported to the State Auditor and management of the Department in a separate letter dated June 15, 2006.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Finding Nos. 05-02, 05-03 and 05-05.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Finding Nos. 05-02 and 05-03 to be material weaknesses.

Principles of Waterhouse Cooper LLP

Honolulu, Hawaii
June 15, 2006

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

State of Hawaii
Department of Health
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

Section I – Summary of Auditor’s Results

Financial Statements:

| | |
|---|---------------|
| Type of auditor’s report issued | Unqualified |
| Internal control over financial reporting: | |
| Material weaknesses identified? | Yes |
| Reportable conditions identified that are not considered to be material weaknesses? | None reported |
| Noncompliance material to financial statements noted? | No |

Federal Awards:

| | |
|---|-----------|
| Internal control over major programs: | |
| Material weaknesses identified? | Yes |
| Reportable conditions identified that are not considered to be material weaknesses? | Yes |
| Type of auditor’s report issued on compliance for major programs | Qualified |
| Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? | Yes |

Identification of Major Programs:

| CFDA Number | Federal Program or Cluster | |
|---|--|-------------|
| | U.S. Department of Health and Human Services | |
| Various | Aging Cluster | |
| 93.283 | Centers for Disease Control and Prevention | |
| 93.917 | HIV Care Formula Grants | |
| 93.959 | Substance Abuse Prevention and Treatment Block Grant | |
| | U.S. Department of Agriculture | |
| 10.557 | Special Supplemental Nutrition Program for Women, Infants and Children | |
| | U.S. Environmental Protection Agency | |
| 66.458 | Capitalization Grants for State Revolving Funds | |
| 66.468 | Capitalization Grants for Drinking Water State Revolving Fund | |
| Dollar threshold used to distinguish between Type A and Type B programs | | \$3,000,000 |
| Auditee qualified as low-risk auditee? | | Yes |

**State of Hawaii
Department of Health
Financial Statement Finding
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

II. Financial Statement Findings

| | | Questioned Cost |
|---|---|----------------------------|
| Finding No. 05-01: | Restatement of Beginning Fund Balance / Net Assets (Material Weakness) | \$ _____ |
| Federal Agency: | Finding is not specific to a Federal Agency | |
| CFDA Number and Title: | Finding is not specific to a Federal Agency | |
| Award Number and Award Year: | Not applicable Not applicable | |

Finding and Cause and Effect

During our current year financial audit of the State of Hawaii, Department of Health (the "Department"), we identified various accounting errors in the Department's basic financial statements as of and for the year ended June 30, 2004 due to the lack of oversight by fiscal management over the calculation of year end balances. Accordingly, the Department restated its opening net assets attributable to governmental activities and governmental funds fund balances as of July 1, 2004 to correct these errors, which were related to the accounting for cash, capital assets, vouchers and contracts payable, accrued wages and employee benefits payable, accrued vacation, and tobacco settlements receivable.

The following table reconciles the net assets attributable to governmental activities at June 30, 2004, as previously reported, to the opening net assets attributable to governmental activities at July 1, 2004, as restated:

| | Governmental Activities |
|---|------------------------------------|
| Net assets at June 30, 2004, as previously reported | \$ 145,391,469 |
| Adjustments attributable to: | |
| Understatement of liabilities and expenses | (15,293,396) |
| Understatement of accrued wages and employee benefits payable | (807,104) |
| Overstatement of accrued vacation | 2,147,481 |
| Understatement of capital assets | 5,706,266 |
| Understatement of beverage container revenue | 582,724 |
| Misclassification of special revenue funds | 53,572 |
| Understatement of cash balances held in State Treasury | 1,233,077 |
| Adjustment for tobacco settlement receivable | 4,550,000 |
| Net assets at July 1, 2004, as restated | \$ 143,564,089 |

State of Hawaii
Department of Health
Financial Statement Finding
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

The following table reconciles the governmental funds fund balances at June 30, 2004, as previously reported, to the opening governmental funds fund balances at July 1, 2004, as restated:

| | Governmental Funds |
|---|-------------------------------|
| Fund balances at June 30, 2004, as previously reported | \$ 98,149,227 |
| Adjustments attributable to: | |
| Understatement of liabilities and expenses | (15,293,396) |
| Understatement of accrued wages and employee benefits payable | (807,104) |
| Understatement of beverage container revenue | 582,724 |
| Misclassification of special revenue funds | 53,572 |
| Understatement of cash balances held in State Treasury | 1,233,077 |
| Fund balances at July 1, 2004, as restated | <u>\$ 83,918,100</u> |

Accounts payable

Upon completion of our search for unrecorded liabilities testing as of June 30, 2005, we noted a significant increase in accounts payable in comparison to June 30, 2004, which we were unable to validate through inquiry with management and review of the predecessor auditor's workpapers. Accordingly, we performed an independent search for unrecorded liabilities as of June 30, 2004, and identified approximately \$15.3 million in additional unrecorded liabilities as of June 30, 2004.

Accrued payroll and benefits

During our testing of the June 30, 2005 accrued payroll balances, we noted that the Department improperly excluded payroll amounts for certain employees impacted by the State of Hawaii's (the "State") payroll lag (payments made subsequent to June 30, 2005 for services rendered through June 30, 2005), resulting in an understatement of the liability. Through inquiry with management and review of the predecessor auditor's workpapers, it was determined that the same error was made as of June 30, 2004, resulting in an understatement of accrued payroll as of June 30, 2004 by approximately \$800,000.

During our testing of accrued vacation as of June 30, 2005, we noted that the Department's vacation liability was improperly calculated by including certain inappropriate fringe benefits (e.g. pension assessments, insurance assessments, etc.), resulting in an overstatement of the liability. Through inquiry with management and review of the predecessor auditor's workpapers, it was determined that the same error was made as of June 30, 2004, resulting in an overstatement of accrued vacation as of June 30, 2004 by approximately \$2.1 million.

Improper classification of special revenue funds

During our review of the Department's major funds and fund classifications, we noted that the Department improperly classified one fund as a fiduciary fund when it should have been classified as a special revenue fund in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34. The fund misclassification resulted in the reclassification of approximately \$53,000 in cash (the only asset of the fund) from fiduciary funds to special revenue funds, and a corresponding reclassification of liabilities to fund balance in the governmental funds financial statements and net assets attributable to governmental activities as of June 30, 2004.

State of Hawaii
Department of Health
Financial Statement Finding
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

Capital assets

During our testing of capital asset additions during fiscal year 2005, we noted that a building capital asset addition was not recorded in the department-wide financial statements in a timely manner. Upon further examination, the Department discovered that the building was placed in service in fiscal year 2002. The error resulted in an understatement of capital assets as of June 30, 2004 by approximately \$5.7 million.

Cash transfers

During our testing of cash transfers between the Department's funds and the State, we identified \$1.2 million in transfers from the State to the Department made during fiscal year 2004, which were not reported in the Department's fiscal year 2004 financial statements, resulting in an understatement of cash as of June 30, 2004.

Revenue recognition

In fiscal year 2004, the State legislature established the Deposit Beverage Container Fund (the "Bottle Fund"), a special revenue fund administered by the Department. The Bottle Fund was determined to be a major fund in the governmental funds financial statements for fiscal year 2005; however was not a major fund in fiscal year 2004. During our fiscal year 2005 testing of the Bottle Fund, we noted that approximately \$583,000 in administrative fee revenues recorded in fiscal year 2005 should have been recorded in fiscal year 2004.

Tobacco Settlements

The Department is responsible for the administration of the Hawaii Tobacco Settlement Special Fund. The Department receives all tobacco settlement monies and then allocates and appropriates 75% of the funds to other State agencies/departments in accordance with Hawaii Revised Statutes ("HRS") 328L-2. Settlement payments are received annually based on tobacco sales each calendar year. The Department did not implement the provisions of GTB 04-01, Question 3, which requires accrual for settlement payments earned between January and June. Through discussion with the State Department of Accounting and General Services ("DAGS") and review of the fiscal 2005/2004 State CAFR, we noted that the State accrued \$18.7 and \$18.2 million in its department-wide statement of net assets as of June 30, 2005 and 2004, respectively, representing half of the total tobacco settlement monies received for calendar year 2005 and 2004. No accruals were recorded in the governmental funds balance sheet since payment was not received within 90 days after fiscal year-end. As the Department is responsible for the receipt and administration of all tobacco settlement monies, the Department should have recorded the same accrual in its department-wide statement of net assets at June 30, 2005 and 2004.

Criteria

§ __.310 of OMB Circular A-133 requires the auditor to prepare financial statements that reflect its financial position, results of operations or changes in net assets and, where appropriate, cash flows for the fiscal year audited.

§ __.320 requires the auditor to submit a reporting package that includes:

- (1) Financial statements and schedule of expenditures of federal awards.
- (2) Summary schedule of prior audit findings.

**State of Hawaii
Department of Health
Financial Statement Finding
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

(3) Auditor's report.

(4) Corrective action plan.

Although audited financial statements were prepared and submitted as of and for the year ended June 30, 2004, the financial statements submitted were misstated, and restated beginning balances are reported in the financial statements as of and for the year ended June 30, 2005.

Recommendation

We recommend that, and the Department has already, restated the beginning balances in its basic financial statements for the year ended June 30, 2005 to correct the errors identified. We also recommend that fiscal management of the Department provide greater oversight to ensure that the basic financial statements are prepared and presented in accordance with *Generally Accepted Accounting Principles* ("GAAP").

State of Hawaii
Department of Health
HIV Care Formula Grants
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

Section III. Federal Award Findings and Questioned Costs

| | | Questioned Cost |
|---|--|----------------------------|
| Finding No. 05-02: | Eligibility Requirements (Material Weakness) | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.917 – HIV Care Formula Grants | |
| Award Number and Award Year: | 2 X07HA00050-14-00 4/1/04 – 3/31/05 2 X07HA00050-15-00 4/1/05 – 3/31/06 | |

Finding and Cause and Effect

During our current year audit, we tested 45 out of 256 patient records. Due to the Department maintaining insufficient supporting documents, we noted the following instances of noncompliance with eligibility requirements for the HIV Care Formula Grants:

- For all 40 patient records tested, the program was unable to provide documentation to evidence the eligibility of the Aids Drug Assistance Program ("ADAP") participants.
- For all 5 patient records tested, the program was unable to provide documentation to evidence the eligibility of H-COBRA participants.
- For 17 out of 40 ADAP patient records tested, the program was unable to provide documentation to evidence that 6-month verbal recertifications were performed.
- For 11 out of 40 ADAP patient records tested, the program was unable to provide documentation to evidence that 12-month semi-annual recertifications were performed.

Criteria

Title 42, Section 300ff-26(b) of the U.S. Code requires that the Department ensure that eligible individuals receive assistance. In order to qualify for assistance, an individual must have a medical diagnosis of HIV disease and be a low-income individual, as defined by the State.

The Notice of Grant Award to the ADAP, the Health Resources and Services Administration ("HRSA") of DHHS expects all Title II grantees to implement an ADAP recertification process to ensure that individuals remain eligible to receive assistance. At a minimum, an individual is required to be recertified every six months to ensure that the program only services eligible clients. The semi-annual recertification process should be both verbal and written.

State of Hawaii
Department of Health
HIV Care Formula Grants
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

Recommendation

We recommend that the Department take the following actions:

- Program personnel should develop and implement a formal participant acceptance process and thoroughly train program staff (and future case managers) on how to review applications for eligibility. All documentation supporting participant eligibility should be retained.
- Program personnel should develop and implement a single comprehensive participant application form for the ADAP and H-COBRA programs. Program personnel should all be knowledgeable of the necessary information to be included in the application and work with participants to ensure that applications are accurately completed.
- Program personnel should conduct semi-annual eligibility recertifications of all participants as required by federal and State program guidelines. In addition, program personnel should review case files periodically to ensure that all participant files contain the required documentation.

State of Hawaii
Department of Health
HIV Care Formula Grants
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | |
|---|--|
| | Questioned Cost |
| Finding No. 05-03: Reporting (Material Weakness) | \$ _____ = |
| Federal Agency: | Department of Health and Human Services ("DHHS") |
| CFDA Number and Title: | 93.917 – HIV Care Formula Grants |
| Award Number and Award Year: | 2 X07HA00050-14-00 4/1/04 – 3/31/05 2 X07HA00050-15-00 4/1/05 – 3/31/06 |

Finding and Cause and Effect

During our current year audit, we noted the following instances of noncompliance with reporting requirements for the HIV Care Formula Grants:

- **Standard Form ("SF")-269.** The amounts of outlays (\$2,084,512 reported versus \$2,121,755 actually expended), planning and evaluation expenditures (\$45,000 reported versus \$49,000 expended) and administrative expenditures (\$45,816 reported versus \$44,729 actually expended) in Section 12 of the SF-269 were incorrectly reported.
- **Final Annual Progress Reports.** The amount of total fiscal year 2004 ADAP funds expended in the Title II Final Progress Report was incorrectly reported: \$2,117,267 (reported) compared to \$2,121,755 (actual). The amount of total fiscal year 2004 Minority AIDS Initiative funds expended in the Implementation Plan Update was incorrectly reported: \$10,577 (reported) versus \$10,025 (actual). The amount of administrative expenses in the Certificate of Aggregate Administrative Costs was incorrectly reported: \$95,653 (reported) versus \$91,653 (actual).
- **CARE Act Data Report ("CADR").** Item 28 (Clients with Hispanic or Latino/a ethnicity) was incorrectly reported for 5 out of 6 reports tested. Item 29 (Race breakdown of all clients) was incorrectly reported for all 6 reports tested.
- **ADAP Quarterly Report.** For the quarter ended June 30, 2005, the number of Native Hawaiian or Other Pacific Islander ADAP participants was incorrectly reported.

The reporting errors were caused by the program not having formalized processes in place to monitor invoices and actual expenditures. Reports appear to be prepared based on budgeted amounts and outdated reports resulting in inaccurate reports submitted to the federal government.

Criteria

Each grant document details the reporting requirements for the respective grant year. There are various requirements and deadlines for each report and these are also detailed in the grant agreements. Failure to

State of Hawaii
Department of Health
HIV Care Formula Grants
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

comply with the reporting requirements may result in deferral or additional restrictions of future funding decisions.

Recommendation

We recommend that program personnel develop and implement procedures to ensure that accurate and complete financial and performance reports are submitted to the awarding agency. Program personnel responsible for reporting should be provided with adequate training and supervision by management.

State of Hawaii
Department of Health
HIV Care Formula Grants
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | |
|---|---|----------------------------|
| | | Questioned Cost |
| Finding No. 05-04: | Earmarking - Minority AIDS Initiative | \$ <u>492</u> |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.917 – HIV Care Formula Grants | |
| Award Number and Award Year: | 2 X07HA00050-14-00 4/1/04 – 3/31/05 | |

Finding and Cause and Effect

During our current year audit, we noted that the total amount of funds earmarked for the Minority AIDS Initiative ("MAI") program of \$10,517 was not expended within the grant period. We noted that there was a \$492 shortfall on the amount spent on the MAI. The \$492 shortfall was caused by the STD/AIDS Prevention Branch not having appropriate procedures in place to monitor and comply with this earmarking requirement.

Criteria

The grant agreement specifies that \$10,517 of the grant funds should be expended for MAI education and outreach services to increase minority participation in the ADAP and access to primary care and support services.

Recommendation

We recommend that program personnel develop and implement procedures to monitor expenditures for specific purposes and ensure compliance with earmarking provisions. Program personnel responsible for monitoring compliance with earmarking provisions should be provided with adequate training and supervision by management.

State of Hawaii
Department of Health
Centers for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-05: | Eligibility (Reportable Condition) | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.283 – Centers for Disease Control and Prevention | |
| Award Number and Award Year: | U55/CCU922046-03 6/30/04 – 6/29/05 | |

Finding and Cause and Effect

During our current year audit, we were not granted access to documentation evidencing verification of income eligibility requirements of participants in the Centers for Disease Control and Prevention program, due to program management's concerns over confidentiality requirements under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). Accordingly, we were unable to verify that priority was given to underserved women in accordance with program requirements.

Criteria

Title 42, Chapter 6a., U.S.C. § 300n, states that to be eligible to receive assistance, priority should be given to underserved women, including those who are older, have low incomes, or are members of racial and ethnic minority groups. Program Announcement 02060 further establishes low income women as being at or below 250 percent of the federal poverty level and uninsured and underinsured. To ensure that the patient meets the low income requirement, patients are required to fill out a "Statement of Eligibility to Participate" Form.

Recommendation

We recommend that program personnel ensure that adequate procedures are in place to verify participant income and ensure that the program is the "payer of last resort" in accordance with federal regulations. We also recommend that program personnel maintain and make available for review, documentation supporting participant eligibility for purposes of audit under OMB Circular A-133.

State of Hawaii
Department of Health
Center for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Substance Abuse Prevention and Treatment Block Grant
Capitalization Grants for State Revolving Funds
Special Supplemental Nutrition Program for Women, Infants, and Children
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-06: | Equipment Management (Reportable Condition) | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| | Environmental Protection Agency ("EPA") | |
| | Department of Agriculture ("USDA") | |
| CFDA Number and Title: | 93.283 – Center for Disease Control and Prevention | |
| | 93.959 – Substance Abuse Prevention and Treatment Block Grant | |
| | 66.458 – Capitalization Grants for State Revolving Funds | |
| Award Number and Award Year: | 10.557 – Special Supplemental Nutrition Program for Women, Infants, and Children U55/CCU922046-03 6/30/04 – 6/29/05 | |
| | 04B1HISAPT-06 10/1/03 – 9/30/05 | |
| | CS-1500010X-0, 10/1/92 – 9/30/10 CS-150001-9X-X | |
| | 7HI700HI7 10/1/03 – 9/30/05 | |

Finding and Cause and Effect

During our testing of internal controls over equipment management for the programs listed above, we noted the following instances of noncompliance with policies and procedures over equipment management as documented in the State Procurement Office's Inventory System User Manual:

Record Keeping

- The Substance Abuse Treatment and Prevention ("SAPT"); Special Supplemental Nutrition Program for Women, Infants, and Children ("WIC"); Capitalization Grants for State Revolving Funds ("CWSRF"); and Centers for Disease Control and Prevention ("NCPC") programs did not update the Fixed Asset Inventory System ("FAIS") records to ensure additions, transfers, and disposals were properly reflected in a timely manner.

**State of Hawaii
Department of Health
Center for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Substance Abuse Prevention and Treatment Block Grant
Capitalization Grants for State Revolving Funds
Special Supplemental Nutrition Program for Women, Infants, and Children
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

- The CWSRF program did not consistently maintain records of inventory printouts and supporting documents.
- The SAPT, CWSRF, and NCPC programs did not consistently reconcile capital expenditures to ensure that property was recorded in FAIS.
- The CWSRF program did not consistently maintain its listing of consumable and non-consumable supplies.
- The SAPT and CWSRF programs did not conduct an annual wall-to-wall physical inventory of equipment items, did not update inventory records to correct discrepancies identified, or updated inventory records in a timely manner.

Safekeeping of Property

- The SAPT, CWSRF, and NCPC programs did not ensure each inventory item was properly tagged or identified.
- The CWSRF program did not notify the Department's record-keeper of property acquired, transferred, identified as excess, or disposed of in a timely manner.

The lack of enforcement by management to comply with the State's equipment management policies and procedures resulted in the noncompliance noted above.

Criteria

40CFR31.32 states that a state will use, manage, and dispose of equipment acquired in accordance with the state's laws and procedures.

Recommendation

We recommend that management of the Department ensure that all divisions and programs adhere to established policies and procedures over equipment management in order to comply with federal regulations.

State of Hawaii
Department of Health
Capitalization Grants for State Revolving Funds
Capitalization Grants for Drinking Water State Revolving Fund
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|------------------------|
| Finding No. 05-07: | Allowable Costs | \$ <u> </u> - |
| Federal Agency: | Environmental Protection Agency ("EPA") | |
| CFDA Number and Title: | 66.458 – Capitalization Grants for State Revolving Funds | |
| | 66.468 – Capitalization Grants for Drinking Water State Revolving Fund | |
| Award Number and Award Year: | CS-1500010X-0, 10/1/92 – 9/30/10 CS-150001-9X-X | |
| | FS-9998659X-1, 12/5/97 – 6/30/11 FS-99986500-1, FS-9998650X-0 | |

Finding and Cause and Effect

During our testing of compliance controls over activities allowed and allowable costs related to the CWSRF program and the Capitalization Grant for Drinking Water State Revolving Fund ("DWSRF") program, we noted that Department personnel responsible for reviewing the allowability and allocability of federal expenditures lacked detailed knowledge and experience with the requirements of Office of Management and Budget ("OMB") Circulars A-133 and A-87, due to the personnel focusing more on grant, program, and EPA requirements.

The lack of well trained personnel in a position of determining compliance with OMB Circulars A-133 and A-87 could result in the inappropriate expenditure of federal funds.

Criteria

To comply with OMB Circulars A-133 and A-87, Department personnel responsible for reviewing the allowability of federal expenditures should be familiar with the criteria of allowable costs as outlined in OMB Circulars A-133 and A-87.

Recommendation

We recommend that the Department ensure that personnel responsible for reviewing and approving federal expenditures are adequately trained and have access to resources to enable them to assess the allowability and allocability of federal expenditures in accordance with OMB Circulars A-133 and A-87.

**State of Hawaii
Department of Health
Center for Disease Control and Prevention –
Public Health Preparedness and Response for Bioterrorism
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-08: | Allowable Costs - Payroll Charges | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.283 – Centers for Disease Control and Prevention | |
| Award Number and Award Year: | U55/CCU922046-03 6/30/04 – 6/29/05 | |

Finding and Cause and Effect

During our testing of compensation costs for the Public Health Preparedness and Response for Bioterrorism, a subprogram of the Center for Disease Control and Prevention program, we noted one instance where \$3,660.23 was improperly charged to this program. The error was due to the untimely processing of an Employee Personnel Action Report ("EPAR") to remove an employee from the program, which was initiated by the Department in October 2004, but not processed by the State's central payroll system until February 2005. The Department corrected the error prior to fiscal year-end via a journal voucher and reimbursed the federal program.

Untimely processing of personnel changes and monitoring of personnel expenditures could result in improper use of federal funds.

Criteria

OMB Circulars A-133 and A-87 state that only allowable costs should be charged as expenditures of federal awards. Under the circulars, only payroll costs for work performed on the federal program in question are considered allowable.

Recommendation

We recommend that the Department ensure that changes to payroll data are made in a timely manner. In addition, payroll expenditures using federal funds should be reviewed for propriety, accuracy and completeness on a regular basis to ensure compliance with OMB Circular A-87.

State of Hawaii
Department of Health
Substance Abuse Prevention and Treatment Block Grant
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-09: | Allowable Costs - Purchase Requisition Approvals | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.959 – Substance Abuse Prevention and Treatment Block Grant | |
| Award Number and Award Year: | 04B1HISAPT-06 10/1/03 – 9/30/05 | |

Finding and Cause and Effect

During our testing of purchasing controls for the SAPT program, we noted that approval of purchase requisitions by supervisors was inconsistently evidenced for the Alcohol and Drug Abuse Division ("ADAD"). The inconsistent approval is due to the lack of a formal requirement to evidence approval of purchase requisitions.

The lack of written approval of purchase requisitions could lead to unauthorized expenditures of federal funds and material financial statement misstatement.

Criteria

OMB Circulars A-133 and A-87 state that a responsible official should review the allowability and allocability of amounts charged to federal awards.

Recommendation

We recommend that the program (and Department) implement a formal requirement for supervisors to evidence their approval of all purchase requisitions to ensure compliance with OMB Circular A-87 and internally documented fiscal procedures.

State of Hawaii
Department of Health
Aging Cluster
Center for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Substance Abuse Prevention and Treatment Block Grant
Capitalization Grants for State Revolving Funds
Special Supplemental Nutrition Program for Women, Infants, and Children
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|-------------------------------|--|--------------------|
| Finding No. 05-10: | Cash Management - Timeliness of Disbursements | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") Environmental Protection Agency ("EPA") Department of Agriculture ("USDA") | |
| CFDA Number and Title: | 93.044 – Special Programs for the Aging – Title III Part B 93.045 – Special Programs for the Aging – Title III Part C 93.053 – Nutrition Services Incentive Program 93.283 – Center for Disease Control and Prevention 93.959 – Substance Abuse Prevention and Treatment Block Grant 66.458 – Capitalization Grants for State Revolving Funds 10.557 – Special Supplemental Nutrition Program for Women, Infants, and Children | |

State of Hawaii
Department of Health
Aging Cluster
Center for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Substance Abuse Prevention and Treatment Block Grant
Capitalization Grants for State Revolving Funds
Special Supplemental Nutrition Program for Women, Infants, and Children
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | |
|------------------------------|----------------------------------|-------------------|
| Award Number and Award Year: | 04AAHIT3SP, 05AAHIT3SP | 10/1/03 – 9/30/05 |
| | 04AAHINSIP, 05AAHINSIP | 10/1/03 – 9/30/05 |
| | U55/CCU922046-03 | 6/30/04 – 6/29/05 |
| | 04B1HISAPT-06 | 10/1/03 – 9/30/05 |
| | CS-1500010X-0, CS-150001-9X-X | 10/1/92 – 9/30/10 |
| | 7HI700HI7 | 10/1/03 – 9/30/05 |

Finding and Cause and Effect

During our testing of the Department's cash management procedures, we noted several instances where the State Department of Accounting and General Services ("DAGS") did not disburse funds from federal sources within three business days after the Department drew down the funds in accordance with the Cash Management Improvement Act Regulations & Guidance 31 CFR 205 (Final Rule). In general, the time lags were not more than a couple of days after the three-day timeframe. We also noted that the Department was not calculating or remitting any interest earnings attributable to these untimely disbursements. The delays were caused by the State's payment process that requires payments by all State departments to be processed through DAGS resulting in processing delays.

Noncompliance with federal regulations could result in a loss of funding that may jeopardize the operations of the Department's federally funded programs.

**State of Hawaii
Department of Health
Aging Cluster
Center for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Substance Abuse Prevention and Treatment Block Grant
Capitalization Grants for State Revolving Funds
Special Supplemental Nutrition Program for Women, Infants, and Children
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

Criteria

OMB Circular A-133 states that entities receiving advances of federal funds must minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the recipient. Circular A-133 also requires that interest earned on advances in excess of \$100 per year should be remitted to the federal government.

The Cash Management Improvement Act ("CMIA") Regulations & Guidance 31 CFR 205 (Final Rule) states:

"Cash advance (pre-issuance or post-issuance) funding means that a Federal Program Agency transfers the actual amount of Federal funds to a State that will be paid out by the State, in a lump sum, not more than three business days prior to the day the State issues checks or initiates EFT payments. . . State interest liability accrues from the day Federal funds are credited to a State account to the day the State pays out the Federal funds for Federal assistance program purposes."

Recommendation

We recommend that the Department work with DAGS to ensure timely disbursement of federal funds. In addition, we recommend that the Department calculate and remit any interest liability to the federal government, if necessary, in accordance with federal regulations.

State of Hawaii
Department of Health
Capitalization Grants for State Revolving Funds
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|-------------------------------------|--|--------------------|
| Finding No. 05-11: | Earmarking - Earmarking for Administrative Expenses | \$ _____ |
| Federal Agency: | Environmental Protection Agency ("EPA") | |
| CFDA Number and Title: | 66.458 – Capitalization Grants for State Revolving Funds | |
| Award Number and Award Year: | CS-1500010X-0, 10/1/92 – 9/30/10 CS-150001-9X-X | |

Finding and Cause and Effect

During our audit of the CWSRF program, we noted that actual administrative expenses incurred for each capitalization grant year were not monitored to ensure that not more than 4 percent of each capitalization grant was used for administrative expenses. The program did not monitor actual administrative expenses due to the lack of a formal policy to do so. However, we were able to validate during our audit that actual administrative expenses did not exceed 4 percent of each capitalization grant.

Without real-time tracking of administrative expenses incurred for each capitalization grant, there is a risk that administrative costs charged to the federal program may exceed the 4 percent ceiling.

Criteria

40 CFR section 35.3120(g) states that SRF funds may be used for the reasonable costs of administering the SRF, provided that the amount does not exceed 4 percent of all grant awards received by the SRF. Expenses of the SRF in excess of the amount permitted under this section must be paid for from sources outside the SRF.

Recommendation

We recommend that the Department develop a procedure to formally monitor actual administrative expenses incurred for each capitalization grant to be in compliance with the 4 percent ceiling.

State of Hawaii
Department of Health
Capitalization Grants for Drinking Water State Revolving Fund
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | |
|---|---|----------------------------|
| | | Questioned Cost |
| Finding No. 05-12: | Earmarking - Earmarking for Local Assistance | \$ _____ |
| Federal Agency: | Environmental Protection Agency ("EPA") | |
| CFDA Number and Title: | 66.468 – Capitalization Grants for Drinking Water State Revolving Fund | |
| Award Number and Award Year: | FS-9998659X-1, 12/5/97 – 6/30/11 FS-99986500-1, FS-9998650X-0 | |

Finding and Cause and Effect

During our audit of the DWSRF program, we noted that expenditures of federal funds earmarked for local assistance were being monitored in total as opposed to the capitalization grant year and specific activity. The expenditures for local assistance were monitored in total due to the lack of a formal policy to monitor those expenditures by grant year and specific activity. However, we were able to validate the program's compliance with the local assistance earmarking requirements substantively during our audit.

The lack of a report or schedule that tracks earmarked expenditures by capitalization grant year and specific activity makes it difficult for program management to ensure that not more than 10 percent of federal expenditures are used for any individual activity to comply with the 10 percent rule.

Criteria

The Local Assistance and other State programs set-aside (15%) section of the EPA Drinking Water State Revolving Fund Guidelines states, "A State may use up to 15% of the capitalization grant amount for specified uses . . . with the stipulation that not more than 10% of the capitalization grant amount can be used for any activity".

Recommendation

We recommend that the Department develop a procedure to formally monitor expenditures by capitalization grant year and by specific activity.

State of Hawaii
Department of Health
Center for Disease Control and Prevention –
National Cancer Prevention and Control Branch
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-13: | Matching | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.283 – Centers for Disease Control and Prevention | |
| Award Number and Award Year: | U55/CCU922046-03 6/30/04 – 6/29/05 | |

Finding and Cause and Effect

During our audit of the National Cancer Prevention Center ("NCPC") program's compliance with matching requirements, we were able to validate that the program complied with the grant-specific matching requirements through a combination of payroll expenditures, contract expenditures, and services donated by the American Cancer Society. The grant also allows the matching requirement to be fulfilled through the donation of time and effort from doctors, nurses and professionals that attend Advisory Council meetings; however, due to the lack of a formal policy, we noted that the program did not formally track such donated time.

The program may need to utilize the donated time to meet the matching requirement in future years. However, without a formal tracking function, the program cannot support any assertion of meeting this matching requirement.

Criteria

Title 42, The Public Health and Welfare, Chapter 6a The Public Health Service, subsection 3001 Requirement of matching funds states:

"In general, the Secretary may not make a grant unless the State involved agrees, with respect to the costs to be incurred by the State in carrying out the purpose described in such section, to make non-Federal contributions (in cash or in kind) toward such costs in an amount equal to not less than \$1 for each \$3 of Federal funds provided in the grant. Such contributions may be made directly or through donations from public or private entities."

Recommendation

We recommend that the program develop and implement a formal process for monitoring all matching sources, including time and effort donated by doctors, nurses, and other professionals that attend Advisory Council meetings.

State of Hawaii
Department of Health
HIV Care Formula Grants
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | |
|---|--|----------------------------|
| | | Questioned Cost |
| Finding No. 05-14: | Earmarking – Quality Management Program | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.917 – HIV Care Formula Grants | |
| Award Number and Award Year: | 2 X07HA00050-14-00 4/1/04 – 3/31/05 2 X07HA00050-15-00 4/1/05 – 3/31/06 | |

Finding and Cause and Effect

During our testing of the HIV Care Formula Grants program, we noted that the program did not have a formalized quality management program in place to monitor whether program activities were consistent with the most recent Public Health Service ("PHS") guidelines, as required under the grant agreement. However, we did note that program personnel were performing quality management activities on an informal basis. We were informed that the Department's Quality Assurance and Evaluation Committee has developed a draft Quality Assurance Plan, which documents the standards for case management service delivery and monitoring of service delivery. The plan is expected to be finalized and implemented in late 2006.

Without a formalized quality management program, the Department is 1) unable to assess the extent to which HIV health services are consistent with the most recent PHS guidelines for the treatment of HIV disease and related opportunistic infections; and 2) cannot effectively and efficiently develop strategies for ensuring that such services are consistent with the guidelines for improvement in the access to and quality of HIV services. The lack of a formalized quality management program could also jeopardize future federal funding for HIV Care programs.

Criteria

42 USC 300ff-22(d) states that a State shall establish a quality management program to determine whether the services provided under the grant are consistent with the most recent PHS guidelines for the treatment of HIV disease and related opportunistic infection and, as applicable, to develop strategies for bringing these services into conformity with the guidelines. Funds used for this purpose may not exceed the lesser of 5 percent of the amount received under the grant, or \$3,000,000.

Recommendation

We recommend that the Department finalize and implement its Quality Assurance Plan in a timely manner to ensure compliance with PHS guidelines and enable the Department to effectively monitor its HIV Care programs.

State of Hawaii
Department of Health
Capitalization Grants for State Revolving Funds
Capitalization Grants for Drinking Water State Revolving Fund
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|---|--------------------|
| Finding No. 05-15: | Reporting – Reviews of Federal Reports | \$ _____ |
| Federal Agency: | Environmental Protection Agency (“EPA”) | |
| CFDA Number and Title: | 66.458 – Capitalization Grants for State Revolving Funds | |
| | 66.468 – Capitalization Grants for Drinking Water State Revolving Fund | |
| Award Number and Award Year: | CS-1500010X-0, 10/1/92 – 9/30/10 CS-150001-9X-X | |
| | FS-9998659X-1, 12/5/97 – 6/30/11 FS-99986500-1, FS-9998650X-0 | |

Finding and Cause and Effect

During our audit of the CWSRF and DWSRF programs’ compliance with financial reporting requirements, we noted, that due to the lack of a formal review policy, instances where Standard Forms (“SF”)-269 and SF-272s were not reviewed in its entirety by the Administrative Services Office (“ASO”) prior to submission.

Without thorough review of financial reports prior to submission, there may be inaccurate reports submitted to the federal government.

Criteria

Under the reporting compliance requirements documented in Part 3 of the March 2004 OMB Circular A-133 Compliance Supplement, it states, “When intervening computations or calculations are required between the records and the reports, trace reported data elements to supporting worksheets or other documentation that link reports to the data.” Therefore, the Department should submit mathematically accurate reports that agree to supporting documents to the federal government.

Recommendation

We recommend that the ASO review all SF-269 and SF-272 reporting packages in entirety prior to submission.

State of Hawaii
Department of Health
Substance Abuse Prevention and Treatment Block Grant
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-16: | Reporting – Timeliness of Reporting | \$ _____ – |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.959 – Substance Abuse Prevention and Treatment Block Grant | |
| Award Number and Award Year: | 04B1HISAPT-06 10/1/03 – 9/30/05 | |

Finding and Cause and Effect

During our audit of the SAPT program's compliance with financial reporting requirements, we noted that the annual SF-269 reporting package was submitted 10 days after the 90-day reporting deadline. The late submission was due to the transactions recorded in the State's accounting system not being recorded and/or processed in a timely manner.

Delinquent reporting could result in the suspension of federal funding for this program.

Criteria

The grant requirements for the Substance Abuse Prevention and Treatment Block Grant state, "Grantees shall submit a Financial Status Report (SF-269 Short Form) by December 31, 2005 which is 90 days after the end of the obligation and expenditure period of this grant."

Recommendation

We recommend that financial reporting packages are completed, reviewed and submitted to the federal government within the required 90-day timeframe.

**State of Hawaii
Department of Health
Substance Abuse Prevention and Treatment Block Grant
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-17: | Reporting – Review of Financial Status Reports | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.959 – Substance Abuse Prevention and Treatment Block Grant | |
| Award Number and Award Year: | 04B1HISAPT-06 10/1/03 – 9/30/05 | |

Finding and Cause and Effect

During our audit of the SAPT program's compliance with financial reporting requirements, we noted that, due to the lack of a formal policy, financial reports and their related reconciliations to Department financial information are reviewed and approved, however the review and approval is not consistently evidenced (*i.e. date of review and initials/signatures*).

Failure to have formalized review procedures could result in inaccurate reporting to the federal government.

Criteria

The Reporting compliance requirements under OMB Circular A-133 require that the reports of federal awards submitted to the federal awarding agency are complete, accurate, and supported by underlying accounting records.

Recommendation

We recommend that the Department implement a policy for supervisors to formally evidence their reviews and approvals of financial reporting packages and all supporting documents.

State of Hawaii
Department of Health
Substance Abuse Prevention and Treatment Block Grant
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

| | | Questioned Cost |
|---|--|--------------------|
| Finding No. 05-18: | Subrecipient Monitoring | \$ _____ |
| Federal Agency: | Department of Health and Human Services ("DHHS") | |
| CFDA Number and Title: | 93.959 – Substance Abuse Prevention and Treatment Block Grant | |
| Award Number and Award Year: | 04B1HISAPT-06 10/1/03 – 9/30/05 | |

Finding and Cause and Effect

The Alcohol and Drug Abuse Division ("ADAD") is responsible for performing subrecipient monitoring procedures for the subrecipients of the SAPT program. ADAD's policy is to perform annual site visits and communicate observations and recommendations for improvement identified during site visits by issuing written monitoring reports to subrecipients within 30 days after site visits. During our audit of the SAPT Block Grant program's compliance with subrecipient monitoring requirements, we noted that site visits were being performed. However, due to understaffing of personnel that perform the monitoring and prepare the reports, several written monitoring reports were not distributed to subrecipients within 30 days after the site visits in accordance with ADAD policies.

Untimely issuance of monitoring reports could lead to uncorrected instances of noncompliance identified during site visits.

Criteria

Under OMB Circular A-133, the Department's SAPT program is responsible for monitoring its subrecipients' activities to provide reasonable assurance that subrecipients administer federal awards in compliance with federal requirements.

Recommendation

We recommend that ADAD continue to perform annual site visits for all subrecipients and issue monitoring reports to subrecipients in a timely manner.

PART V

PRIOR YEAR FINDINGS AND QUESTIONED COSTS

This section updates the status of findings and questioned costs that were reported in prior years. Finding numbers relate to the sequence reported by the prior auditor in the respective year.

**State of Hawaii
Department of Health
Financial Statement Finding
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2005**

Financial Statement Finding

Finding No. 04-01: Fixed Assets

During the fiscal year 2004 audit, it was recommended that the Department report capital asset additions to the State in a timely manner in accordance with the Department of Accounting and General Services ("DAGS") – State Procurement Office ("SPO") – Inventory Management Branch Training Manual ("State Inventory Manual"). It was also recommended that the Department implement a procedure for property custodians to reconcile quarterly equipment acquisitions in the State's Financial Accounting and Management Information System ("FAMIS") to DAGS computerized inventory reports ("MDB reports") in a timely manner.

Action Taken / Response

The Department had all division property custodians reconcile fiscal year 2004 capital asset activity in FAMIS to MDB reports, which were due to the SPO by April 15, 2005.

However, during the current year financial audit, additional instances of untimely capital asset addition were noted. Refer to Finding No. 05-01 for additional information on the untimely capital asset additions noted during our current year audit.

**State of Hawaii
Department of Health
Public Health Preparedness and Response for Bioterrorism
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2005**

Federal Award Findings and Questioned Costs

Finding No. 04-02: Equipment Management

During the fiscal year 2004 audit, it was recommended that the Public Health Preparedness and Response for Bioterrorism program (CFDA 93.283) report equipment acquisitions in a timely manner to the State Procurement Office and ensure that program personnel are adequately trained on inventory procedures.

Action Taken / Response

Program personnel performed a physical inventory of all equipment in December 2004. In addition, program personnel implemented procedures to identify miscoded equipment items, whereby an accounting clerk scans expenditure reports and compares expenditures to the MDB 020 report on a monthly basis to ensure equipment is properly coded.

However, equipment recordkeeping problems in several other programs of the Department were noted in the current year audit. Refer to Finding No. 05-06 for additional information.

**State of Hawaii
Department of Health
State Survey and Certification of Health Care Providers and Suppliers
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2005**

Finding No. 04-03: Reporting

During the fiscal year 2004 audit, it was recommended that the State Survey and Certification of Health Care Providers and Suppliers program ensure that information presented on required reports (e.g., CMS 435 State Survey Agency Budget/Expenditure Report) is accurate and complete prior to submission to the awarding agency.

Action Taken / Response

The fiscal year 2005 CMS 435 State Survey Agency Budget/Expenditure Report was prepared by the Administrative Services Office ("ASO") Accountant and an indirect cost rate of 14% was used to calculate and report indirect costs. This percentage agreed to the fiscal year 2005 rate in the "State and Local Rate Agreement" dated September 30, 2004.

State of Hawaii
Department of Health
Capitalization Grants for Drinking Water State Revolving Fund
Schedule of Prior Year Findings and Questioned Costs
Year Ended June 30, 2005

Finding No. 04-04: Matching

During the fiscal year 2004 audit, it was recommended that the Capitalization Grants for Drinking Water State Revolving Fund (the "Fund") separately calculate, reconcile and track State matching funds expenditures in order to monitor compliance with the federal requirement that State funds spent or set aside equal or exceed federal expenditures.

Action Taken / Response

The Fund was able to calculate and reconcile State matching set-aside funds back to fiscal year 2003 and is currently maintaining adequate documentation to support compliance with the matching requirement on a prospective basis.

Status

Although the Fund was able to calculate and reconcile State matching set-aside funds back to fiscal year 2003, the Fund is still expending State matching set-aside funds from fiscal year 1999. The Fund still does not have adequate documentation to evidence compliance with the matching requirement between fiscal years 1999 through 2002. We recommend that the Fund calculate and reconcile State matching set-aside funds for fiscal years 1999 through 2002 to validate compliance with the matching requirement.